FILE COPY

Office - Supreme Court, U. S
FILED
OCT 13 1937
CHARLES ELMORE CROPLEY
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 30

UNITED STATES OF AMERICA, ON RELATION OF CHESTER A. WILLOUGHBY, AS TRUSTEE IN BANKRUPTCY OF NATIONAL MECHANICAL SERVICE COMPANY, A CORPORATION, ET AL.,

Petitioners,

vs.

SAM HOWARD AND CONTINENTAL CASUALTY COMPANY, A CORPORATION,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENTS.

JULIUS MOSES,
LLOYD HETH,
WILLIAM P. SMITH,
Counsel for Respondents.

WALTER BACHRACH,
STANLEY J. MORRIS,
R. WEYAND,
Of Counsel.

CHICAGO LAW PRINTING CO., 111 N. WACKER DRIVE (COR. WASHINGTON ST.) TEL. FRANKLIN 0621

TABLE OF CONTENTS.

	PAGE
Opinion below	1
Jurisdiction	2
Statement of the case	2
Deposit of bankruptcy funds in the Phillip State and borrowings for the benefit of the estates	3
Condition of Phillip State and the bank runs, August 1930—June, 1931	8
Activity of the bankruptcy court in June, 1931 in supervising the depositories	10
July, 1931—June, 1932	13
Closing of Phillip State	16
Other bankruptcy depositories in Chicago	16
The case as submitted to the jury	18
Summary of argument	21
Argument	23
The express conditions of the trustees' and receivers' bonds were never broken	23
The case involves no failure of Howard to obey any order of the bankruptcy court	23
There was no breach of the condition of the bonds requiring Howard to account	25
The condition assuring Howard's performance of his official duties as trustee or receiver in bankruptcy was never violated	29

PAGE

Under the depository system established by the Bankruptcy Act for assuring the safety of bankruptcy funds coming into the possession of trustees and receivers, no duty is owed by the trustee or receiver when making or maintaining deposits of funds in a designated depository of the bankruptcy court, to determine with care the condition or stability of the depository 36

Responsibility of fiduciaries and public or quasi-public officers for funds placed in their custody and lost in a bank failure 37

The depository system in bankruptcy 40

The trustee or receiver in bankruptcy and his duties with respect to funds coming into his possession for safekeeping..... 41

The bankruptcy court as the designating and administrative authority 46

The designating depository and funds in its possession 47

A fiduciary or public or quasi-public officer who deposits funds under a depository system, is not liable for their loss through a closing of the designated depository 48

Policy of the rule in bankruptcy 61

The rule of non-responsibility is not affected by the number of banks qualified as depositories in the district, assuming such questions were before this Court; nor does the rule present any issue under the Fifth Amendment 63

No question of fraud, corruption, malfeasance or bad faith is presented for review 68

PAGE

The risk covered by the bonds did not contemplate the solvency of any designated depository in which a trustee or receiver may have deposited bankruptcy funds 73

If it be assumed that a trustee or receiver in bankruptcy, in making or maintaining deposits of bankruptcy funds in a designated depository, owes a duty of care to guard against loss through a closing of the depository, nevertheless, in this case under the facts proved and what matters this court may judicially notice, Howard violated no such duty 75

Condition of the bank 76

Materiality of the proof of loans on whether the supposed duty of care arose and was discharged 96

If the case on the record was one for a jury to decide, nevertheless, the judgment in the District Court was properly reversed and the cause remanded for a new trial, for the reason that reversible error was committed in the District Court's rulings upon the admission and exclusion of evidence, in remarks of the court during the trial, in restrictions placed upon argument of counsel for respondents, in instructions given to the jury, in refusal to instruct as requested by respondents, and in the forms of verdict submitted 100

The number of assignments of error in the case at bar was necessary in order to preserve the errors committed below 101

Erroneous admissions of evidence 102

Testimony of petitioners' witnesses with respect to seeing runs, hearing rumors of insolvency and of making personal withdrawals of money 102

PAGE

Loans made by Phillip State Bank to Howard 103

Statistical data showing comparison per month between estate deposits at the Phillip State and various assets and liabilities of bank 104

Existence of other bankruptcy depositories during the period reviewed 105

Erroneous exclusions of evidence 105

Purpose for which Howard borrowed money from Phillip State Bank and practice of trustees and receivers in bankruptcy with regard to making advances to estates out of their personal funds 105

Amount of bankruptcy funds deposited by receivers and trustees in depositories other than the Phillip State during the period under review 108

The reason for the closing of the Phillip State 109

Inquiry made in early June, 1931, by the designating authority into the general banking situation then prevailing and the amount of the bonds of the depositories in bankruptcy; the telephone request made of all trustees and receivers to file with the authority a report of bankruptcy funds in the depositories and Howard's report of June 9, 1931, with respect thereto; the exercise of administrative functions by the court thereafter 111

Improper remarks of the court during trial 115

PAGE

Improper restrictions placed by the trial court upon the argument of counsel for respondents to the jury 115

Improper instructions to the jury 116

Reversible error was committed by the District Court in instructing the jury that it could not consider occurrences outside the proof in the case although such occurrences were matters of common knowledge 116

Reversible error was committed in the comments of the court on the matter of the loans made by the Phillip State to Howard 117

Reversible error was committed in instructing the jury to disregard the relationship between the Central Trust and the Phillip State in determining whether an ordinary prudent person would have made deposits in the Phillip State during the period under review.... 118

Reversible error was committed in presenting the case to the jury in a one-sided way 119

Reversible error was committed in directing the jury upon what conditions they were to find for the defendant..... 119

Reversible error was committed in refusals of requests of respondents to instruct the jury 120

Conclusion 121

PAGE

Table of Cases Cited.

A

American Surety Co. of New York v. City of Thomasville, 73 F. (2d) 584 (C. C. A. 5) 52
Anderson v. Peterson State Bank, 191 Minn. 404, 254 N. W. 459 61
Anguera v. Yturria, 80 F. (2d) 57 (C. C. A. 5) 38

B

Barney v. Saunders, 57 U. S. (16 How.) 535 ..... 38, 87
Benson v. American Surety Co. of N. Y., (Minn. 1937) 271 N. W. 125, 126 56
Bingaman v. Commonwealth Trust Co., 1 F. (2d) 505, 506, (D. C. Pa.) 41
Board of Commissioners v. Elmund, 94 Minn. 196, 102 N. W. 719, 720 89
Board of Comrs. v. Soucek, 128 Okla. 151, 261 Pac. 947 61
Board of County Com'rs v. Mason, 38 Wyo. 1, 264 Pac. 93 47
Board of Education v. Nelson, 33 N. D. 462, 157 N. W. 664 ..... 54, 60, 89
Board of Finance v. First National Bank, 71 Ind. App. 290, 124 N. E. 768 ..... 46, 58, 114
Brennan v. Eubank, (Tex. Civ. App.) 56 S. W. (2d) 513, 515 ..... 79, 116

C

Campbell v. American Bonding Company, 172 Ala. 458, 55 So. 306 31
Carey v. Safe Deposit & Trust Co. of Baltimore, 168 Md. 501, 178 Atl. 242 ..... 38, 88, 116

PAGE

C

Cheyenne v. Maryland Casualty Co., 13 F. (2d) 401 (D. C. Wyo.) 61
City of Billings v. Mass. Bonding & Ins. Co., 88 Mont. 91, 290 Pac. 246 60
City of Missoula v. Dick, 76 Mont. 502, 248 Pac. 193, 195 60
City of New Haven v. Fresenius, 75 Conn. 145, 52 Atl. 823, 825 58
City of Newburgh v. Dickey, 150 N. Y. S. 175, 178, 164 App. Div. 791 ..... 34, 58
City of Parsons v. Fidelity & Deposit Co., 29 F. (2d) 417, (D. C. Kan.) reversed on other grounds 43 F. (2d) 315 (C. C. A. 10) 31, 45, 47
City of Salisbury v. Lyerly, 208 N. C. 386, 180 S. E. 701, 703 30
City of Scranton, Pa. v. Aetna Casualty & Surety Co., 11 F. Supp. 986 (D. C. Pa.) 50, 59
City of Wilkes Barre v. Rockafellow, 171 Pa. St. 177, 33 Atl. 269, 270, 50 Am. St. Rep. 795, 30 L. R. A. 393 ..... 30, 32
Clemons v. Dennis, (Va.) 181 S. E. 387 88
In re Cobb, 112 Fed. 655 (D. C. N. C.) 45
County of Marshall v. Bakke, 182 Minn. 10, 234 N. W. 1, 4 89

D

Dewey v. Des Moines, 173 U. S. 193 69
District of Columbia v. Petty, 229 U. S. 593 30

E

Edwards v. Logan County, 244 Ky. 296, 50 S. W. (2d) 59, 83
In re John A. Etheridge Furniture Co., 92 Fed. 329 (D. C. Ky.) 24

PAGE

G

Gardner v. Chicago Title & Trust Co., 261 U. S. 453....44, 47
Germanic, The, 196 U. S. 589, 596 98
Great Northern Railway Co. v. Weeks, 297 U. S. 135, 149 .....76, 116
Gross v. Butler, 48 Ga. App. 750, 173 S. E. 866 88

H

Hale County, Texas v. American Indemnity Co., 63 F. (2d) 275 (C. C. A. 5) 27
Harper v. Betts, 177 Ark. 977, 8 S. W. (2d) 464.....38, 87
Hart v. Savary, 114 Fla. 41, 152 So. 705 .....38, 88
Home Building & Loan Ass'n v. Blaisdell, 290 U. S. 398, 422, 444 116
In re Howard, 130 Fed. 1004 (D. C. Cal.) 46
In re Hoyt, 119 Fed. 987, 988, (D. C. N. C.) 42, 45
In re Hoyt v. Mitchell, 127 Fed. 968 (D. C. N. C.)....27, 43, 45
Huttig Mfg. Co. v. Edwards, 160 Fed. 619, 622-623 (C. C. A. 8) 42, 45

I

Illinois Surety Co. v. United States, 226 Fed. 665, 667 (C. C. A. 7) 43, 60
Imperial Assurance Co. v. Livingston, 49 F. (2d) 745, 748, 749 (C. C. A. 8) 41, 44

J

Joint School District No. 105 v. First National Bank, 125 Okla. 243, 257 Pac. 318, 319 58
Jordon v. Baker, 252 Ky. 40, 66 S. W. (2d) 84 59

K

In re Kohler's Estate, 15 Wash. 613, 47 Pac. 30 .....38, 88
In re Kruger's Estate, 141 Misc. 475, 252 N. Y. Supp. 688 88
In re Kyle, 181 Fed. 617, 621 (C. C. Mass.) 42, 43,45

PAGE

L

Local 167, I B. T. v. United States, 291 U. S. 293, 296.... 101
Lowe v. City of Guthrie, 4 Okla. 287, 44 Pac. 198, 200-201 30

M

Magee v. Bristow, 109 Miss. 183, 68 So. 77, 78 57
Mass. Bonding & Ins. Co. v. Steele, 125 Neb. 7, 248 N. W. 648 61
McCrary v. Schenebeck, 191 Ark. 698, 87 S. W. (2d) 572, 574 ..... 17, 66
Mecklenberg County v. Beales, 111 Va. 691, 69 S. E. 1032, 36 L. R. A. (N. S.) 285 37
Meehan v. King, 54 F. (2d) 761, 763 (C. C. A. 1) 41
Miller v. Batson, 160 Miss. 642, 134 So. 567 ..... 47, 58
In re Mullen's Estate, 97 Mont. 144, 33 Pac. (2d) 270 88

N

Neff v. Harmon, 145 Okla. 114, 291 Pac. 518 ..... 38, 88

O

In re Ocean City Title & Trust Co.'s Bond, 6 F. Supp. 311 (D. C. N. J.) 43, 44, 46
In re Olson's Estate, 206 Ia. 706, 219 N. W. 401 ..... 38, 88
Orton v. City of Lincoln, 156 Ill. 499, 41 N. E. 159 30

P

In re Perelstine, 44 F. (2d) 62 (D. C. Pa.) 27
Perkins v. State, 130 Miss. 512, 94 So. 460 47
Perley v. County of Muskegon, 32 Mich. 132, 135..... 53
In re Potell, 53 F. (2d) 877, 879 (D. C. N. Y.)..... 42, 46
Potter v. Fidelity & Deposit Co., 101 Miss. 823, 58 So. 713, 715 ..... 45, 47

PAGE

P

Prudential Ins. Co. v. Hart, 205 Ia. 801, 218 N. W. 529 88
Purdy v. Bank of America, 2 Cal. (2d) 298, 40 Pac. (2d) 481, 482 72

R

R. J. Reynolds Tobacco Co. v. A. B. Jones Co., 54 F. (2d) 329 (C. C. A. 8) 27, 32, 42
Roberts County v. Wickard, 53 S. D. 511, 221 N. W. 246 61
Rosebud County v. Smith, 92 Mont. 75, 9 Pac. (2d) 1071, 1073 89

S

In re Singer Furniture Corp., 47 F. (2d) 780, 783 (D. C. N. Y.) 43, 48
State v. Bobleter, 83 Minn. 479, 86 N. W. 461 40
State v. Bowers, 26 Oh. Cir. Ct. 326, aff'd. 70 Oh. St. 423, 72 N. E. 1155 ..... 33, 59
State v. Carney, 208 Ia. 133, 217 N. W. 472 61
State v. Copeland, 96 Tenn. 296, 34 S. W. 427, 434 38, 85, 95
State v. Gramm, 7 Wyo. 329, 52 Pac. 533, 40 L. R. A. 690 38
State of Kansas v. U. S. Fed. & Guar. Co., 81 Kan. 660, 106 Pac. 1040, 26 L. R. A. (N. S.) 865 47
State v. Krause, 186 Wis. 59, 202 N. W. 319, 322-323 90
State v. McNamer, 62 Mont. 490, 205 Pac. 951 ..... 59, 60
State v. U. S. Fed. & Guar. Co., 210 Wis. 178, 246 N. W. 434 ..... 47, 61
In re State Treasurer's Settlement, 51 Neb. 116, 70 N. W. 532, 537 47
Stephens v. City of Ludlow, 159 Ky. 729, 169 N. W. 473, 475 ..... 57, 59
In re Stone's Assignment, 220 Ia. 1341, 264 N. W. 604 38, 82

PAGE

T

Thunder Hawk School District, No. 8 v. Western Surety Co., 58 S. Dak. 312, 235 N. W. 921 78
Town of Cameron v. Hicks, 65 W. Va. 484, 64 S. E. 832, 17 Ann. Cas. 926 37
Town of Danbury v. Riedmiller, 208 Ia. 879, 226 N. W. 159 ..... 38, 88
Town of Hamden v. American Surety Company of New York, 9 F. Supp. 733 (D. C. Conn.) 48, 50
Town of Lakeland v. Ballmer, 209 Wis. 636, 245 N. W. 682, 683 60

U

United States v. Rehwald, et al., 44 F. (2d) 663 (D. C. Cal.) 27
United States v. Union Sur. & Guar. Co., 118 Fed. 482, 486 (D. C. N. Y.) 41

V

Virginia Ry. v. Mullens, 271 U. S. 220 69

W

In re Walker Grain Co., 3 F. (2d) 872, 874 (C. C. A. 5) 24
In re Welch's Estate, 100 Mont. 47, 45 Pac. (2d) 681 ..... 38, 88
Wilson v. People, 19 Colo. 199, 34 Pac. 944 ..... 38, 88
In re Workman's Estate, 196 Ia. 1108, 196 N. W. 35 ..... 38, 88

PAGE

STATUTES.

Bankruptcy Act, Sec. 33 (11 U. S. C. A. 61) 41
Bankruptcy Act, Sec. 39(a) (11 U. S. C. A. 67(a)) 28
Bankruptcy Act, Sec. 47(a)(3) (11 U. S. C. A. 75(a)(3)) 27, 31, 42, 92
Bankruptcy Act, Sec. 47(a)(4) (11 U. S. C. A. 75(a)(4)) 31, 45
Bankruptcy Act, Sec. 47(a)(5) (11 U. S. C. A. 75(a)(5)) 31
Bankruptcy Act, Sec. 47(a)(6) (11 U. S. C. A. 75(a)(6)) 31
Bankruptcy Act, Sec. 47(a)(7) (11 U. S. C. A. 75(a)(7)) 31
Bankruptcy Act, Sec. 47(a)(8) (11 U. S. C. A. 75(a)(8)) 31
Bankruptcy Act, Sec. 47(a)(9) (11 U. S. C. A. 75(a)(9)) 28
Bankruptcy Act, Sec. 47(a)(10) (11 U. S. C. A. 75(a)(10)) 32, 44, 46
Bankruptcy Act, Sec. 48 41
Bankruptcy Act, Sec. 50(b) (11 U. S. C. A. 78(b)) 24
Bankruptcy Act, Sec. 50(c) (11 U. S. C. A. 78(c)) 74
Bankruptcy Act, Sec. 50(h) (11 U. S. C. A. 78(h)) 46
Bankruptcy Act, Sec. 61 (11 U. S. C. A. 101) 31, 43, 46, 64
Bankruptcy Act, Sec. 65(a)(b) (11 U. S. C. A. 105(a)(b)) 28

General Order 29 (11 U. S. C. A. 53) 32, 45, 47
General Order 40 (11 U. S. C. A. 53) 41

PAGE

General Order 53 (11 U. S. C. A. 53) 46

General Orders & Forms in Bankruptcy No. 25 (11 U. S. C. A. 53) 24

Judicial Code, Sec. 240(a) (28 U. S. C. A. 347(a)) 2

Ky. Acts, 1934, c. 22 59

12 U. S. C. A. 90 49

31 U. S. C. A. 153 49

TEXTS.

Vol. 1, C. J. 596, Sec. 1 25

38 American Law Reports 1512 68

Duncan & Reilley, *Bankruptcy In Canada*, 2d ed., p. 373 48

A. S. Woodman, *A treatise in the Law of Trustees in Bankruptcy*, 1909, p. 51, Sec. 35(a) 42, 47

Williams Bankruptcy Practice, 14 ed. p. 395 48

2 Cooley on Const. Law (8th ed.) p. 756 68

Wigmore, *Evidence*, 2d ed. Vol. III, Sec. 1801 116

REPORTS.

Statement Showing Total Resources and Liabiilties of Illinois State Banks—*at the close of business June 29, 1935*—compiled by Edward J. Barrett, Auditor of Public Accounts for the State of Illinois, pp. 26, 28, 31, 32 ..... 17, 66

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 30

UNITED STATES OF AMERICA, ON RELATION OF CHESTER A. WILLOUGHBY, AS TRUSTEE IN BANKRUPTCY OF NATIONAL MECHANICAL SERVICE COMPANY, A CORPORATION, ET AL.,

Petitioners,

vs.

SAM HOWARD AND CONTINENTAL CASUALTY COMPANY, A CORPORATION,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENTS.

OPINION BELOW.

The opinion of the Circuit Court of Appeals is reported in 87 F. (2d) 243 (R. 393). The District Court delivered no opinion.

JURISDICTION.

The jurisdiction of this Court was invoked under Section 240(a) of the Judicial Code, as amended, 28 U. S. C. A. 347(a). The judgment of the Circuit Court of Appeals was rendered January 8, 1937 (R. 393) and a rehearing in that court was denied January 29, 1937 (R. 406). This Court granted a review on writ of certiorari May 24, 1937.

STATEMENT OF THE CASE.

Three separate suits at law were instituted in the United States District Court for the Northern District of Illinois, Eastern Division, on the relation of the petitioner Chester A. Willoughby, acting as successor trustee in bankruptcy of one hundred and fourteen estates and as successor receiver in bankruptcy of nine other estates, to enforce the alleged contractual liability of the respondents Sam Howard and the Continental Casualty Company, principal obligor and surety respectively, on one hundred and twenty-three official bonds given by Howard as predecessor trustee and receiver of the estates. A recovery was sought on the bond of each estate for an amount of funds belonging to such estate, deposited by Howard in the Phillip State Bank and Trust Company of Chicago and lost when that depository closed in 1932. The actions proceeded upon the theory that the making of deposits, and the maintenance on deposit, of bankruptcy funds in the bank under the circumstances of the case constituted a breach of the condition of each bond (R. 2-10). The three suits were consolidated for trial and heard together in the District Court, and a verdict and judgment in each was rendered for petitioners (R. 51-59, 383-386). Respondents thereafter perfected an appeal to the Circuit Court of Appeals for the Seventh

Circuit and that court, with one judge dissenting, reversed the judgments below and ordered a new trial (R. 405-406, 393). Petitioners then sought review on certiorari in this Court of the judgment of the Circuit Court of Appeals.

Each of the bonds sued upon recited Howard's appointment as trustee or receiver of the particular estate in which the bond was given and provided in substance that the respondents would pay any loss which might be sustained by the estate from (a) a failure of Howard to obey an order of court, (b) a failure of Howard faithfully and truly to account for all moneys, assets and effects of the estate, and (c) a failure of Howard faithfully to perform "his official duties as said trustee" or receiver (R. 59-60, 65-66).

DEPOSIT OF BANKRUPTCY FUNDS IN THE PHILLIP STATE AND BORROWINGS FOR THE BENEFIT OF THE ESTATES.

For the past ten years, Sam Howard has been receiver and trustee of numerous bankrupt estates pending in the District Court for the Northern District of Illinois (R. 253). Prior to the middle of 1930, bankruptcy funds were kept by Howard on deposit in the Central Trust Company of Illinois and in the Foreman State National Bank of Chicago (R. 164, 257-258, 275). Howard was indebted to the Central Trust for $2,500 and to the Foreman Bank for $7,500 (R. 223-230, 258). [Proof offered at the trial by respondents but refused by the District Court on grounds of immateriality, showed that these amounts had been borrowed by Howard on his own credit for the benefit solely of the estates in order to furnish them with cash needed for the payment of services rendered by various persons to the estates (R. 229-230, 258-259). Further proof, also offered and refused, showed that advances

of this nature were regularly repaid Howard out of the funds in the estates upon order of the bankruptcy court at the time it approved his trustee's and receiver's reports (R. 209-215, 229, 254). The trial court further refused to permit respondents to show that under a well known and uniform practice prevailing in the Northern District of Illinois and approved by the bankruptcy court in that district, receivers and trustees in bankruptcy advanced to their estates the moneys required to meet and pay estate expenses for which they received reimbursement out of the estates upon approval of their accounts by the court (R. 254, 208). Error on these rulings was assigned in the Circuit Court of Appeals but was not considered by that court in view of the decision which it reached (R. 326, 402).]

Prior to July, 1930, and over a period of many years, Howard conducted the banking business of his estates, at the Central Trust, with Clarence A. Beutel, one of its vice-presidents (R. 255, 163, 164). In late July, 1930, Beutel, in visiting Howard, stated that at the suggestion of the Central Trust he had recently become president of the Phillip State Bank & Trust Company of Chicago, and asked Howard if he would make deposits of bankruptcy funds at that bank (R. 255, 163, 164). The Phillip State was one of the well known banks located on the "north side" of Chicago and had been established for over fifteen years (R. 286, 256). Beutel explained that the Central Trust held in pledge a substantial amount of the stock of the Phillip State and was interested in its future (R. 255-256, 165, 191). Howard stated that he knew the Phillip State well as he himself lived on the north side and that he would consider making deposits there (R. 255-256). Howard inquired whether the bank granted the same loan accommodations which had

been extended at the Central Trust and other banks, loans used in making advances to bankrupt estates for the purpose of meeting expenses arising in the course of administration (R. 164, 257). Beutel replied that he was well acquainted with loans of that type and that the Phillip State made them (R. 165-166, 256). Later, in August 1930, Howard told Beutel that he had considered favorably making deposits at the Phillip State (R. 165). Beutel suggested that the bank could take over the outstanding loans at the Foreman Bank and the Central Trust if Howard furnished a satisfactory financial statement (R. 165, 257-258, 192).

On August 6, 1930 the Phillip State Bank, upon receiving Howard's financial statement, loaned Howard $5,000 at the current rate of interest (R. 223, 77). The statement showed real estate and some fifteen or sixteen thousand dollars owed him on account of advances to, and estimated earnings by way of commissions in, various bankrupt estates administered by him (R. 258, 168). Howard used $2,500 of this loan to pay the Central Trust obligation (R. 223-229, 258). On August 19, 1930, he made a second loan for $6,000 and used the money borrowed together with other funds to pay the $7,500 owed the Foreman Bank (R. 223, 77, 229, 258).

On August 25, 1930, Howard began depositing bankrupt estate funds at the Phillip State (R. 73). Before making the deposit, he examined the records in the office of the clerk of the District Court and ascertained that the Phillip State was a duly designated depository of the bankruptcy court for the deposit of bankrupt estate funds and that a depository bond approved by the court had been filed (R. 259). The order of designation placed no restriction whatever upon the bank's receipt of funds, neither by way of limitation on amount nor otherwise (R.

143). In that month Howard opened thirty-three estate accounts at the Phillip State and deposited in them, in the aggregate, $249,968.15 (R. 73). Only nine of these accounts are among those included in the present suit (R. 73).

About the same time, Howard opened with the bank two commercial accounts, known respectively as the "Sam Howard Account" and the "Sam Howard Special Account" (R. 74-76, 223). The first was an office account used to meet expenses incurred in the various bankrupt estates (R. 223, 230). In it were deposited all moneys paid Howard upon order of the bankruptcy court as reimbursement for personal advances made to the estates in paying estate expenses, and likewise the money borrowed from the Phillip State as hereinafter stated (R. 223). The Special Account was used as a deposit account for commissions allowed Howard by the court for his services in administering the estates (R. 223). When the general office account would become low, funds from the Special Account would be transferred to it (R. 230). Between September and December 1930, Howard kept from one to two thousand dollars in both of these accounts (R. 74). For the first six months of 1931 the amount ranged between three and four thousand dollars; for the last six months of that year between six and eight thousand, and from then until the close of the bank in June, 1932, likewise between six and eight thousand (R. 74). When the bank closed, Howard had on deposit in the two accounts $5,853.63 (R. 74).

In addition to the two loans made to Howard by the Phillip State in August 1930, four later loans were made. In September 1930, he borrowed $2,500, in February 1931, $1,500, in the following May, $2,500 and in July 1931, $1,015 (R. 77-78, 115). All of these loans were

time loans with interest at rates varying from 4½% to 6% per annum, were approved by the directors and loan committee of the bank and made upon Howard's personal financial statement (R. 77-78, 168-169, 258). With the exception of the loan for $1,015 which was repaid, each of the five remaining loans was extended, and at the close of the bank the total amount of these loans, $17,500, was outstanding (R. 77-78). Loans of this kind had the regular approval of the Chicago Clearing House Association (R. 174). [The trial court, after admitting over objection of respondents proof of these loans, refused to permit respondents to show that, as with the Central Trust and Foreman Bank loans, the amounts borrowed were not for Howard's individual use or gain but wholly for the benefit of the estates which he administered, to be kept in the special revolving account above mentioned and employed in making petty cash advances to these estates in order to pay estate expenses recurring in the course of administration, such as insurance, mimeographing and stenographic fees, bookkeeping, custodian and inventory service fees, etc. (R. 207, 208, 223, 230, 251-252, 254, 258). The trial court further refused proof that in 1930, 1931 and 1932 Howard made such advances in a substantial amount to all of the estates which he administered and that he advanced to the estates involved in these suits alone over $12,000, for which he has never been repaid (R. 206-207). Error was assigned in the Circuit Court of Appeals on the refusal of the trial court to admit the foregoing proof but was not considered in view of the court's decision (R. 324, 325-326).]

From August 1930 continuously until the close of the bank, the Phillip State served as depository for funds belonging to bankrupt estates administered by Howard. The aggregate of some $250,000 of bankruptcy funds there

deposited by Howard in the thirty-three estates in August 1930 as heretofore stated, was increased during the next three months by deposits in those and in new accounts, to $390,000; and from that time until shortly before the close of the bank in June 1932, the amount on deposit in bankruptcy accounts varied between these two figures (R. 72). In the two months preceding June 1932, there was a small increase, and on June 21st of that year when the bank closed, the aggregate on deposit in the one hundred and twenty-three bankruptcy accounts stood at $416,833.90 (R. 72, 275). Interest was paid on the deposits at the usual rates fixed by the clearing house association (R. 273, 274).

Condition of Phillip State and the Bank Runs, August 1930—June 1931.

In August 1930 at the time Howard opened his first bankruptcy account with the Phillip State the total resources of the bank were four million dollars (R. 139). By December 1930 these had increased to four million six hundred thousand dollars (R. 139). The quarter-annual financial statement of the bank issued as of September 24, 1930, which Howard received and examined, showed total resources $4,534,377.88 which included bonds and securities $1,275,558.50, loans $2,413,813.08 and cash resources $551,369.46; total deposit accounts $3,590,455.68, and capital stock, surplus and undivided profits $752,717.83 (R. 86, 87, 271). Subsequent quarter-annual statements issued as of December 31, 1930 and March 25, 1931 reflected little change except for increases in total resources, cash resources and government securities (R. 89, 91, 92).

In the middle of April 1931, within a period of five days, four banks located on the north side of Chicago

closed their doors (R. 137). The failure of these banks precipitated bank runs on other north side banks (R. 169, 259). At the Phillip State a million dollars in deposits was withdrawn within the course of two or three days (R. 169, 72). As the run there developed, Beutel telephoned Howard and other large depositors and told them not to feel concerned, that the Phillip State was in a sound condition and that the Central Trust Company was advancing all cash necessary to meet the demand (R. 169, 259). About a week later Howard met with the officers of the bank and was informed that during the run, officials and directors of the Central Trust had visited the Phillip State, reassured depositors of the stability of the bank and publicly announced on the bank floor that the Central Trust would support the Phillip State to the fullest extent (R. 170-171, 260). The Central Trust loaned the Phillip State about a million dollars (R. 169).

By June 1931, the money borrowed from the Central Trust had been repaid and withdrawn deposits were commencing to return to the Phillip State (R. 176, 72). On June 7, 1931 two of the largest banks of Chicago, both located in the "loop" or business area of the city, merged with two other "loop" banks, in an attempt to save several hundred million dollars of deposits (R. 121). The National Bank of the Republic, a bankruptcy depository, merged with the Central Trust to form a new bank, the Central Republic Bank and Trust Company (R. 121, 201). The Foreman State National Bank, also a depository, having total deposits of nearly two hundred million dollars, was taken over by The First National Bank of Chicago (R. 121, 113).

With the announcement of the two mergers came a series of runs on outlying banks of the city (R. 171).

On June 8th on the south side, two banks, both bankruptcy depositories, closed (R. 138, 113). On the north side five banks closed (R. 137). At the Phillip State, depositors began a new run on the bank and withdrew about five hundred thousand dollars in deposits (R. 171, 193, 72).

ACTIVITY OF THE BANKRUPTCY COURT IN JUNE 1931 IN SUPERVISING THE DEPOSITORIES.

[The trial court refused the following proof offered by respondents: On or about June 8, 1931, Judge Carpenter, senior judge of the District Court for the Northern District of Illinois, called into conference Joseph Muir, chief deputy clerk of the court, for the purpose of discussing the banking situation, particularly the deposits of bankrupt estate funds in the bankruptcy depositories (R. 144, 145). The whole subject was reviewed with the judge, the amount of such funds in the depositories gone over, the size of the depository bonds examined (R. 145). Judge Carpenter directed Muir to telephone the various receivers and trustees in bankruptcy and ask them to file statements showing in what depositories they kept their funds and the respective amounts thereof (R. 148). Muir was also told to prepare a draft order for the court to enter directing the receivers and trustees to file periodic reports of their bankruptcy deposits (R. 145). Following this conference, Muir telephoned the receivers and trustees, including Howard, and told them of the court's request for a statement (R. 148, 263). On June 9, 1931, Howard filed such report showing $373,391.49 of bankruptcy funds in the Phillip State and $10,952.19 in the Foreman Bank (R. 148, 263, 154-155). Error was assigned in the Circuit Court of Appeals on the refusal of the trial court to admit this evidence but consideration

thereof was unnecessary under the decision reached (R. 319-321, 402).]

Shortly thereafter, Judge Carpenter communicated with Beutel at the Phillip State and conferred with him about the depository bond of the bank (R. 173). Judge Carpenter mentioned that Howard was carrying a substantial amount of bankruptcy funds in the bank and said that he thought the bond was too small (R. 173). Beutel told Judge Carpenter that he understood that because of the general banking conditions, bonding companies were cancelling bonds and refusing to write new ones. He also told Judge Carpenter to call Philip R. Clark, the president of the Central Republic, regarding the situation (R. 173). Judge Carpenter replied that instead of speaking with Mr. Clark he would call upon General Dawes, that he knew General Dawes (R. 173). The depository bond of the Phillip State was never thereafter ordered to be increased nor was the receipt by it of bankruptcy funds from receivers and trustees in the district in any way restricted as to amount or otherwise (R. 113).

About the same time that Judge Carpenter spoke with Beutel, Howard made inquiry of the officers of the Phillip State to find out what effect the bank mergers had had (R. 171, 193). Howard was told of the conversation between Judge Carpenter and Beutel, and of the judge's intention to call upon General Dawes (R. 173). He also was told that the officers felt no concern over general conditions inasmuch as they had the assurance of the Central Republic that it would give them full assistance to meet any emergency demand; that Clark had written a letter, which he had authorized to be published, stating that the Central would support the Phillip State in the general stress (R. 171-172). Howard examined the letter, which read: "Dear Mr. Beutel: We are co-operat-

ing with the loop banks in sending millions of dollars to the outlying banks, and are prepared to lend them further support consistent with sound banking practice. * * * In this emergency we are glad to lend our support if needed to the Phillip State Bank & Trust Company'' (R. 179). Howard told Beutel that with the Foreman banks closing and the general banking situation being what it was, he knew of no safer place than the Phillip State (R. 194).

On June 11, 1931 the District Court for the Northern District of Illinois, in an order entered by Judge Carpenter, directed all receivers in bankruptcy to file with the clerk of the court, every three months commencing July 1, 1931, a statement showing the amount of estate deposits respectively kept in the depository banks (R. 145, 134, 149). Although the order in words was limited to receivers, it was understood that trustees likewise were to report such deposits (R. 204-205, 134). On June 12th a certified copy of the order reached Howard through the mail and some weeks later his office prepared a report stating the amount of bankruptcy funds on deposit, as of June 30, 1931, in the Phillip State and in the Foreman Bank (R. 204, 264, 217). Approximately $300,000 was shown in the Phillip State (R. 217). The report was duly filed with the clerk of the court and together with reports filed by other receivers and trustees, was delivered to Judge Carpenter (R. 264, 148, 150, 153).

[The trial court refused to admit evidence offered by respondents which showed the following: After the June 11th order was entered, Judge Carpenter instructed the clerk to bring him all reports filed thereunder (R. 162). Upon receiving the June reports, the judge had his secretary prepare for his use a typewritten compilation thereof, setting forth, in the instance of each depository,

the names of all receivers and trustees who kept deposits there, and the amounts, both separately and in the aggregate, of their deposits (R. 156-158). The compilation stated the amount of Howard's deposits in the two depositories and disclosed, among other things, that in the National Bank of the Republic, the depository which had merged in early June with the Central Trust and whose bond had been fixed at $50,000.00, an aggregate of $1,103,783.32 of bankruptcy funds had been on deposit; that in the Foreman Bank, which also had then merged and whose bond was for $50,000.00, an aggregate of $331,333.76 funds had been deposited (R. 157, 163). The rulings of the trial court in connection with the proof of these facts were assigned as error in the Circuit Court of Appeals but likewise were not there considered because of the decision reached (R. 323, 322, 402).]

JULY 1931—JUNE 1932.

In early July 1931 Howard received and examined the quarter-annual statement of the Phillip State issued as of June 30, 1931 (R. 94, 271). While the April and June withdrawals were reflected, capital, surplus and undistributed profits remained unchanged (R. 94). Compared with the statement of March 25, 1931, deposits showed a decrease of $1,300,000 ($1,000,000 in April, $500,000 in June, with $200,000 returned), the decrease being from $3,811,638 to $2,464,138 (R. 92). Correspondingly, total resources decreased $1,000,000, from $4,601,248 to $3,660,960 (R. 91). An item of $300,000 "bills payable" evidently represented an advance by the Central Republic to the Phillip State in June (R. 182, 176).

During the summer of 1931, business at the Phillip State continued uneventfully except for the taking over by the bank of the Illinois State Bank of Evanston, a

small institution with $200,000 in resources and liabilities (R. 129, 131). On September 21, 1931, the Rogers Park National Bank, situated directly across the street from the Phillip State, closed (R. 173, 138). This, coming in the aftermath of the closing of the so-called "Bain chain", a group of twelve banks located in different parts of the city of Chicago, resulted in a run on the Phillip State (R. 195, 173). Howard telephoned Beutel, then secretary of the National Credit Association, a pool formed by the banks because of the general situation, and asked what effect the closing of the Rogers Park would have on the Phillip State (R. 174, 265). Beutel stated that the run was to be expected but that there was no need for concern, that the Chicago Clearing House Association in a general survey of the banking situation had examined the bank and designated it an "A" institution (R. 265, 174-175). Beutel also mentioned that the Central Republic had, as on previous occasions, advanced the necessary funds, and related that the Central Republic had increased its interest in the Phillip State (R. 173, 266, 174, 194). In October 1931, Howard received the quarter-annual statement of the Phillip State issued as of September 29, 1931 (R. 96). Compared with the statement of June 30th, total deposits were about $130,000 less, having decreased from $2,464,138.78 to $2,325,529.72 (R. 94, 96). (An exhibit introduced by petitioners showed an increase in total deposits at the end of September, over June deposits, by about $50,000 (R. 72).) Total resources decreased approximately $195,000, from $3,660,960 to $3,464,837 (R. 94, 96). On the other hand, cash resources and government securities increased over $200,000 from $445,922 to $649,644, and bills payable and money due other banks decreased over $50,000 (R. 94, 96). Capital stock, surplus and undivided profits remained the same (R. 96).

About the time the bank statement was received, Howard prepared and filed the September report for the district court as required by the order of June 11th (R. 205, 265). The report showed, as of September 30, 1931, deposits of approximately $250,000 of bankruptcy funds in the Phillip State and also deposits in the First National Bank (R. 205, 217, 265).

During the succeeding nine months, that is, from September 1931, until the close of the Phillip State in June 1932, business at the bank continued without material change. Howard met Beutel from time to time and discussed the efforts at stabilization being made by the National Credit Association and the Reconstruction Finance Corporation (R. 175). While a heavier, steady withdrawal of deposits occurred during the week of Christmas 1931, total deposits at the Phillip State varied little from October to January, and in February and March increased $310,000 (R. 177, 72). From January to June, bills payable were reduced by two-thirds, from $375,351 to $154,248 (R. 139). The quarter-annual statements issued as of December 31, 1931 and March 30, 1932, showed a further increase of $55,000 in cash and government securities (R. 98-99, 101, 96). In March 1932 the bank reached its highest point of liquidity for the period with quick assets constituting 37.54% of the total deposits (R. 72). Total resources continued around $3,500,000 (R. 101).

In January and April, 1932, Howard prepared the trustee's and receiver's report required by the order of June 11th (R. 205-206, 253). The January return showed $258,624.98 of bankruptcy funds in the Phillip State as of December 31, 1931; the April return showed $385,632.85 on deposit as of March 30, 1932 (R. 205-206). Both reports were duly filed with the clerk of the district court (R. 253).

Closing of Phillip State.

On June 18, 1932, the Devon Trust and Savings Bank, located on the north side of Chicago, closed its doors (R. 138). Within an hour thereafter, a run started on the Phillip State (R. 177, 122). There was no reason for anticipating it (R. 121-122). The bank remained open until 9:30 in the night in order to meet the demand of depositors who wished to withdraw (R. 122, 177). Howard was not in Chicago at the time and knew nothing of the situation (R. 266, 178). On the following Monday, June 20th, the run continued and on June 21st the bank closed (R. 122, 177-178). [The trial court refused to permit respondents to show that the cause of the closing of the Phillip State was a repudiation by the Central Republic of its promise to advance funds to the Phillip State in an emergency, and also would not permit respondents to show the circumstances under which the refusal was made (R. 178). Error on this ruling was assigned in the Circuit Court of Appeals but likewise not there considered because of the decision handed down (R. 315, 316).]

Thereafter a receiver was appointed for the Phillip State and its affairs have since been in process of liquidation (R. 39).

Other Bankruptcy Depositories in Chicago.

Petitioners introduced evidence over the objection of respondents showing that there were twenty-one banks which had had depository bonds on file in the District Court for the Northern District of Illinois during the period from August 1, 1930 to June 21, 1932, and the respective amounts of such bonds (R. 112-113, 107-112). This proof was permitted to stand without peti-

tioners being required to prove that any of these depositories was safer during the period than the Phillip State. Petitioners offered no evidence of the financial condition of these banks at that time, of the respective amounts of bankruptcy funds then kept on deposit in them, or of the relationship between such deposits and the particular depository bonds.* It already appeared that two of these depositories failed on June 8, 1931, and that two others, both large "loop" banks, had been compelled to merge with other banks (R. 138, 121, 201). An offer of proof by respondents on the comparative security of the other depositories was refused by the trial court (R. 277). These

---

*Such proof, if offered, would have established that of the twenty-one depositories, five-sevenths either failed or had been, or were compelled to merge. The record supplemented by the official report of the Illinois State Auditor, *Statement showing Total Resources and Liabilities of Illinois State Banks,—at the close of business June 29, 1935,* pp. 26, 28, 31, 32, of which judicial notice may be taken, *McCrary* v. *Schenebeck,* 191 Ark. 698, 87 S. W. (2d) 572, 574, shows the following:

Depositories which failed: South Side Trust & Savings Bank, Washington Park National Bank, Peoples Trust & Savings Bank, South Side Bank & Trust Company, Transportation Bank of Chicago, Chicago Bank of Commerce, Cosmopolitan State Bank, Edgewater Trust & Savings Bank, Jackson Park National Bank, Woodlawn Trust & Savings Bank.

Depositories which merged: Foreman State National Bank, National Bank of the Republic, both of which were "loop" banks, Chicago Trust Company, State Bank of Chicago and Union Trust Company.

One of the depositories listed, the Oak Park Trust and Savings Bank of Oak Park, Illinois, was not located in Chicago and was first designated a depository less than a month before the Phillip State closed (R. 113).

rulings were assigned as error in the Circuit Court of Appeals but were not passed upon under the decision (R. 318-319, 322, 402).

THE CASE AS SUBMITTED TO THE JURY.

Petitioners tried the cause in the District Court on the theory that Howard, in making and maintaining deposits of bankruptcy funds in the Phillip State, was negligent, and that such alleged negligence constituted a breach of the condition of each bond sued upon, entitling petitioners to recover the amount of funds belonging to the estate in which such bond was given and which was lost when the bank closed (R. 8, 9, 10). Respondents challenged as a matter of law the assumption that the condition of the bonds comprehended, and that Howard had owed, a duty to regard the stability and safety of a bank which the bankruptcy court had designated a depository for bankruptcy funds; and denied as a matter of fact that Howard under the circumstances of the case had ever violated such a duty even were it supposed to have existed (R. 32, 35, 141, 291, 305, 306-307). The District Court accepted the theory of liability advanced by petitioners that such duty had been owed, and evidence on that basis was accordingly introduced. The statement in petitioners' brief, pp. 45-46, that the charged violation of the supposed duty had not been denied as a matter of fact, is untrue (R. 41, 44, 45).

During the trial, the court, as heretofore stated, permitted petitioners to show the making of the loans by the Phillip State to Howard (R. 77-78, 81), but excluded proof offered by respondents showing that the money had been borrowed on Howard's personal credit for the benefit only of the bankruptcy estates which he administered, in accordance with an established practice among trustees and

receivers in bankruptcy (R. 229-230, 258-259, 208, 209-215, 229, 254). The trial court permitted petitioners, as heretofore stated, to show the twenty-one depositories located in the bankruptcy district at some time during the period, without requiring any supporting proof of their respective financial position or strength (R. 112-113), and rejected an offer by respondents to pursue a line of such proof (R. 277). The court permitted the repeated retelling by six witnesses, called successively by petitioners, of the two runs at the Phillip State which occurred prior to July, 1931 (R. 117-118, 123-128) but prohibited counsel for respondents, in their argument to the jury, to refer as of common knowledge to the general banking situation in Chicago, in the district and in the country during the period (R. 290-291). The court, as heretofore stated, excluded proof offered by respondents showing that at the time of the city-wide runs in June, 1931, which followed the two mergers, the senior judge of the bankruptcy court of the district had had under consideration the effect of banking conditions on the security of the bankruptcy funds in the depositories, and had called for and received reports from the trustees and receivers, including Howard, of the respective amounts of such funds on deposit (R. 145, 148, 263, 154-155).

In its charge to the jury the trial court instructed that the jury was not privileged to consider occurrences outside the proof in the case although such occurrences were matters of common knowledge (R. 296). The court devoted its entire charge with the exception of one sentence to presenting the facts relied upon by petitioners and ignored the facts or theories of defense submitted by respondents (R. 295). The court, in a substantial portion of its charge commented in severe terms on the loans which Howard had made although evidence showing that the money had been

borrowed for the benefit of the estates had been excluded (R. 298-299). The court, in the only portion of its charge dealing with the conditions on which the jury could find for respondents, instructed that the jury could so find only if the evidence showed that the Phillip State was in a safe condition and that there was nothing there involving great hazards to the funds and that Howard knew of nothing which would challenge his right to deposit there (R. 299).

The foregoing rulings and instructions of the trial court, and others hereinafter discussed, were assigned as error in the Circuit Court of Appeals but were not there reviewed because of the decision reached (R. 313-345, 402).

SUMMARY OF ARGUMENT.

The express conditions of the trustee's and receiver's bonds were never broken. The case involves no failure of Howard to obey any order of the bankruptcy court. There was no breach of the condition of the bonds requiring Howard to account. The condition assuring Howard's performance of his official duties as trustee or receiver in bankruptcy was never violated.

Under the depositary system established by the Bankruptcy Act for assuring the safety of bankruptcy funds coming into the possession of trustees and receivers, no duty is owed by the trustee or receiver when making or maintaining deposits of funds in a designated depository of the bankruptcy court, to determine with care the condition or stability of the depository. The rule of non-responsibility is not affected by the number of banks qualified as depositories in the district, assuming such questions were before this Court; nor does the rule present any issue under the Fifth Amendment.

No question of fraud, corruption, malfeasance or bad faith is presented for review.

The risk covered by the bonds did not contemplate the solvency of any designated depository in which a trustee or receiver may have deposited bankruptcy funds.

If it be assumed that a trustee or receiver in bankruptcy, in making or maintaining deposits of bankruptcy funds in a designated depository, owes a duty of care to guard against loss through a closing of the depository, nevertheless, in this case under the facts proved and what mat-

ters this Court may judicially notice, Howard violated no such duty.

If the case on the record was one for a jury to decide, nevertheless, the judgment in the District Court was properly reversed and the cause remanded for a new trial, for the reason that reversible error was committed in the District Court's rulings upon the admission and exclusion of evidence, in remarks of the court during the trial, in restrictions placed upon argument of counsel for respondents, in instructions given to the jury, and in refusal to instruct as requested by respondents.

ARGUMENT.

Petitioners' brief, in its statement of the principal question presented, p. 4, in its specification of errors to be urged, p. 14, and in the argument made throughout, has sought to impress upon this case the stamp of fraud and corruption. No assertion of the presence of either was made in the trial court. Issue was there joined and the case tried on the question solely of whether Howard had conformed to the general standard of due care in performing a supposed duty of judging the condition of the Phillip State when making bankruptcy deposits there. The complaint alleged no fraud or corruption (R. 2-10); the question of whether Howard had been guilty of any fraud or corruption was never submitted to the jury (R. 295-300). The charge is made here, although unheralded by anything below and without foundation in the record.

I.

THE EXPRESS CONDITIONS OF THE TRUSTEES' AND RECEIVERS' BONDS WERE NEVER BROKEN.

The recovery sought of the respondents depends wholly upon the extent of their undertaking in the bonds sued upon. The measure of their responsiveness in these suits can have no greater breadth than that to be found in the language of the bonds. A risk-bearing agency, not merely Howard, has been made party to this cause, and its alleged liability can be adjudged only in the light of the risk it in fact assumed. Whether a depression loss may be shifted to it must rest on its contract.

The trustee's bonds involved are official bonds required by Section 50 of the Bankruptcy Act (11 U. S. C. A. 78(b)), and are in the form prescribed by the General Orders and Forms in Bankruptcy, No. 25 (11 U. S. C. A. 53). The receiver's bonds are likewise official bonds, *In re Walker Grain Co.*, 3 F. (2d) 872, 874 (C. C. A. 5); *In re John A. Etheridge Furniture Co.*, 92 Fed. 329 (D. C. Ky.). The respondents, under the express terms thereof, bound themselves to pay any loss resulting to the estates from (a) a failure of Howard to obey any order of the bankruptcy court entered in relation to the estates, (b) a failure of Howard faithfully and truly to account for all moneys, assets, and effects of the estates, and (c) a failure of Howard faithfully to perform his official duties as trustee or receiver (R. 59, 65).

A.

The Case Involves no Failure of Howard to Obey Any Order of the Bankruptcy Court.

There is no evidence whatsoever of a breach of the proviso of the bonds assuring performance by Howard of orders of the bankruptcy court. The record discloses no instance in which Howard failed to obey any order made in relation to the estates, and there certainly is no showing that the proximate cause of the loss sustained by the estates was the disobedience by Howard of a court order.

Petitioners say, p. 18, that respondents did not produce the reports which Howard had made "from June 9, 1931 until after June 11, 1932," pursuant to the order of June 11, 1931 (petitioners inaccurately refer to the order as of July 1, 1931) (R. 145-146), that "secondary evidence was given to show that something had been taken to the clerk's office from time to time," and that the "jury was entirely

justified in believing that Howard had not made any such report * * * save to a deputy clerk, on June 9, 1931."

The record shows that the reports filed by Howard under the June 11th order were lost and that upon proper foundation being laid, the fact of the preparation and due filing of such reports, and the precise contents of each report, were established by the testimony of several witnesses (R. 204-206, 264-265, 252-253, 217, 148, 153, 160, 184). Petitioners' statement that the jury was justified in believing that no report had been made ignores the fact that the trial court never submitted to the jury any issue upon his failure to report (R. 295 *et seq.*), and in effect directed a verdict to the contrary. Further, petitioners' reference to the report of June 9, 1931 is confusing. That report was filed not under the June 11th order which directed the filing of statements commencing July 1, 1931, but in response to Muir's request, on Judge Carpenter's instruction, in early June for an immediate report from the trustees and receivers pending the entry of the June 11th order (R. 148).

B.

There was no Breach of the Condition of the Bonds Requiring Howard to Account.

The second condition of the bonds is that Howard shall faithfully and truly, or well and truly, account for all moneys, assets and effects of the estates coming into his hands and possession. Inasmuch as moneys alone are involved in these suits, the portion of the proviso dealing with assets and effects need not be considered.

The word "account" as used in written instruments has been variously construed in the decisions (1 C. J. 596, sec. 1). It is not one of art, and reference to the different

interpretations is of little value. In the bonds sued upon, the word "account" is preceded by the expression "faithfully and truly," or "well and truly." The use of the word in this context would indicate that all that was required of Howard was his making an honest and accurate report or statement as to what money had come into his hands and the manner in which he had disposed of it. Giving the word, however, a broader significance, the condition that Howard "account" may fairly be taken as meaning that principal and surety assumed responsibility for loss in either of two instances; *first,* if Howard failed to make honest and accurate reports or accountings of estate funds as required of him by statute, or order or rule of court, or other authority; *second,* if the disposition of the funds as so reported or accounted for, was not pursuant to law.

The record discloses no dereliction by Howard in the making or rendering of any reports or accounts of the funds of the estates which he was under duty to make. It was stipulated that Howard made and duly filed with the bankruptcy court and its referee, in each of the estates involved, during the course of administration, the usual periodic reports and accounts of estate funds required of all trustees and receivers in bankruptcy under the statutes and rules (R. 144, 266). The reports required by the order of June 11, 1931, were made, as heretofore stated.

Nor does the record show that the disposition of the funds as thus reported and accounted for, was contrary to law. The reports filed and accountings made disclosed to persons interested, whether the bankruptcy court, the creditors of the estate, or the casualty company, that the funds belonging to the estates had been deposited and were on deposit with a designated depository of the bankruptcy court. Actual deposit of the funds with the deposi-

tory was not only pursuant to law but required by law. Section 47 (a)(3) of the Bankruptcy Act (11 U. S. C. A. 75(a)(3)) imposes a mandatory duty on trustees in bankruptcy to "deposit all money received by them in one of the designated depositories," and receivers in bankruptcy have a similar obligation, *R. J. Reynolds Tobacco Co.* v. *A. B. Jones Co.*, 54 F. (2d) 329 (C. C. A. 8).

It will be observed that this cause is not concerned with the usual issues of an accounting case brought against a trustee where improper withdrawals or disbursements are charged, cf. *In re Hoyt & Mitchell,* 127 Fed. 968 (D. C. N. Car.), *In re Perelstine,* 44 F. (2d) 62 (D. C. Pa.). The funds claimed for the one hundred and twenty-three estates were never used nor disbursed by Howard; they were on deposit with the depository and were lost when the depository closed its doors. The sole question which might arise with respect to such disposition of the funds in accordance with law would relate to whether, as a matter of law, an official duty existed in Howard, as trustee or receiver in bankruptcy, to judge, with care, the condition or stability of the designated depository in which estate funds were deposited, and if it did exist, whether as a matter of fact it had been performed. This question is considered hereinafter, pp. 36-67, 75-99.

Petitioners refer, p. 19, to *Hale County, Texas* v. *American Indemnity Company,* 63 F. (2d) 275 (C. C. A. 5) and *U. S.* v. *Rehwald, et al.,* 44 F. (2d) 663 (D. C. Cal.) as defining the meaning of "account" in a bond. Neither case is in point. The first does not involve the bond of an official under duty to deposit in a designated depository but that of the depository itself, and holds consistent with authority that the liability is that of an insurer. The second case concerns the use of "account" in a criminal statute.

Petitioners say, p. 20, that "Howard had the primary duty of distributing" the bankruptcy funds on deposit in the Phillip State, and that "Because of the delay in payments, if for no other reason, and the final loss because of such delay, there was not a faithful accounting." This suggestion that the loss to the estates occurred because of a delay in distribution to creditors, apparently finds its source in a similar suggestion contained in the dissenting opinion below (R. 403). There is nothing in the record concerning any delay in the regular administration and progress of any of the estate involved, let alone in which one of the estates such alleged delay occurred. The complaint did not so aver but on the contrary showed that the larger number of accounts here involved had been opened at the Phillip State during the latter part of the period under review (R. 12-29). No evidence of any delay was ever offered; the trial court did not so charge (R. 294 *et seq.*); and petitioners never so contended, whether in the District Court or in the Circuit Court of Appeals. Nor was there any "primary duty" in Howard to distribute. Receivers in bankruptcy make no distribution pending adjudication. Trustees in bankruptcy can make payments only when the referee has prepared the dividend sheets and declared the dividend, and then the payments must be made within ten days, Secs. 39(a), 65(a)(b), 47 (a)(9) of the Bankruptcy Act (11 U. S. C. A. 67 (a)), 105 (a)(b), 75 (a)(9). No evidence whatsoever was introduced relative to the declaration or payment of dividends in any of the estates. Petitioners' statement, p. 20, that of the $132,707 deposited to the credit of National Theatre Corporation on August 25, 1930, $52,174.17 "still" was on deposit at the time of the closing of the bank, is without foundation in the record. There is no showing in respect to this, or any other account, of the extent of withdrawals of funds

originally deposited, or their replacement by new deposits. Funds on deposit at the close of the bank did not necessarily represent original deposits.

C.

The Condition Assuring Howard's Performance of His Official Duties as Trustee or Receiver in Bankruptcy was Never Violated.

The trustee's bonds were further conditioned on Howard's faithful performance of "his official duties as said trustee" (R. 59-60); the receiver's bonds, on the discharge of "the duties of his trust as such receiver" (R. 65-66). It is agreed that in legal intendment the provision of the receiver's bonds is in this respect the same as that of the trustee's (petitioners' brief, pp. 32, 9).

The problem of construction presented is what conduct on Howard's part was thereby embraced, what risk did the casualty company undertake under this requirement of the bonds assuring performance of "official duties"? Both petitioners and the trial court assumed as a matter of law in presenting and submitting the case to the jury that a want of ordinary care by a trustee or receiver in regarding the financial condition of a designated depository in which estate deposits were made and in judging the possibility of such depository being closed, whether by a bank run or otherwise, would constitute a violation of his official duties as trustee or receiver within the meaning of his bond, and his surety would become liable for the loss. It was conceived that the duties of the trustee or receiver in bankruptcy with respect to depositing estate funds in a designated depository were identical with those of the common law trustee or fiduciary making deposits.

Are these, official duties of a trustee or receiver in bankruptcy? Did the casualty company in executing each bond assure any one interested that Howard would determine, with care, the condition and stability of any designated depository in which he deposited bankruptcy funds? Hereafter, pp. 36-67, it will appear that under the depository system established in bankruptcy for the safekeeping of bankruptcy funds, such duty was lodged elsewhere than in the trustee or receiver and an elaborate machinery for securing the safety of funds set up. At the present, the inquiry is more narrow and is confined to a construction of the bonds in the light of the official duties imposed by the Bankruptcy Act and General Orders upon trustees and receivers.

The law has distinguished between the so-called official bond of an officer or quasi-officer required by law to secure the performance of his official duties, and the ordinary, common law bond. Liability on an official bond cannot be resolved by mere examination of the language of the bond. The bond can be construed only by strict reference to the law or statute creating the office and providing the duties thereof. A surety on an official bond undertakes merely that the officer or quasi-officer will faithfully perform those duties stated and defined by law as pertaining to his office, not any act in which the officer may chance to engage. While conduct of an officer resulting in loss may render him liable as a matter of general law, it does not necessarily follow that a recovery may be had therefor on his official bond, *District of Columbia* v. *Petty*, 229 U. S. 593; *City of Wilkes Barre* v. *Rockafellow*, 171 Pa. St. 177, 33 Atl. 269, 270, 50 Am. St. Rep. 795, 30 L. R. A. 393; *Lowe* v. *City of Guthrie*, 4 Okla. 287, 44 Pac. 198, 200-201; *City of Salisbury* v. *Lyerly*, 208 N. C. 386, 180 S. E. 701, 703; *Orton* v. *City of Lincoln*, 156 Ill. 499, 41 N. E. 159;

City of Parsons v. *Fidelity & Deposit Co.*, 29 F. (2d) 417 (D. C. Kan.), reversed on other grounds 43 F. (2d) 315 (C. C. A. 10); *Campbell* v. *American Bonding Company*, 172 Ala. 458, 55 So. 306.

Section 47 of the Bankruptcy Act (11 U. S. C. A. 75) sets forth the official duties of the trustee which relate to the handling of funds pending disbursements or distribution, as follows: The trustee in bankruptcy shall—

"Deposit all money received * * * in one of the designated depositories" (11 U. S. C. A. 75 (a)(3));*

"Disburse money only by check or draft on the depositories in which it has been deposited" (11 U. S. C. A. 75 (a)(4));

"Furnish such information concerning the estates * * * and their administration as may be requested by parties in interest" (11 U. S. C. A. 75 (a) (5));

"Keep regular accounts showing all amounts received and from what sources and all amounts expended and on what accounts" (11 U. S. C. A. 75 (a)(6));

"Lay before the final meeting of the creditors detailed statements of the administration of the estates" (11 U. S. C. A. 75 (a)(7));

"Make final reports and file final accounts with the courts fifteen days before the day fixed for the final meetings of the creditors" (11 U. S. C. A. 75 (a)(8));

---

*The depositories referred to are provided by section 61 of the Bankruptcy Act (11 U. S. C. A. 101) which is as follows: "Courts of bankruptcy shall designate, by order, banking institutions as depositories for the money of bankrupt estates, as convenient as may be to the residences of trustees, and shall require bonds to the United States, subject to their approval, to be given by such banking institutions, and may from time to time as occasion may require, by like order increase the number of depositories or the amount of any bond or change such depositories."

> "Report to the courts, in writing, the condition of the estates and the amounts of money on hand, and such other details as may be required by the courts, within the first month after * * * appointment and every two months thereafter, unless otherwise ordered by the courts" (11 U. S. C. A. 75 (a)(10)).

The duty of the trustee to disburse money only by check or draft on the depository in which the estate funds are deposited is supplemented by General Order No. 29 (11 U. S. C. A. 53), which provides that such check or warrant shall be countersigned by a judge of the bankruptcy court, or a referee designated for that purpose, or by the clerk of the court or his assistants under an order made by the judge.

The duties of the receiver in bankruptcy relating to the handling of estate funds prior to adjudication are the same as those of the trustee, *R. J. Reynolds Tobacco Co.* v. *A. B. Jones Co.*, 54 F. (2d) 329, 335 (C. C. A. 8).

Thus expressed in the statute, the enumerated duties of the trustee or receiver in bankruptcy include no duty to determine with care the financial condition or stability of the depository in which estate funds are deposited. Under the Act the extent of the official duties of such officer with reference to the handling of estate funds pending adjudication or distribution are these: he must deposit the funds in one of the designated depositories of the court; he may make disbursements only upon a duly countersigned check or warrant; he must keep regular accounts thereof and file the required reports.

Petitioners' brief, pp. 23-26, refers to the cases of *City of Wilkes Barre* and others above cited, and agrees with the rule which they announce that a surety on an official bond may be held responsible only for failure to perform his offi-

cial duties, but contends that the rule is inapplicable. Petitioners argue, apparently, that the duty of a receiver or trustee in bankruptcy to deposit funds in a designated depository is a duty *virtute officii,* that duties *virtute officii,* if done negligently and with loss, result in liability of the surety, and that accordingly a failure by a receiver or trustee to determine with care the condition and stability of a designated depository when making or maintaining a deposit of funds therein constitutes a negligent discharge of the duty to deposit, for which liability may be imposed on the surety.

Undoubtedly, a deposit by a trustee or receiver in a designated depository is an act done *virtute officii,* and duties *virtute officii* may occasion liability to the surety if performed negligently. The argument, however, begs the question. It does not follow that a failure to determine with care the condition of a designated depository is a negligent discharge of the duty to deposit. That depends on the scope of the duty. The duty to deposit in a designated depository is a duty to deposit in a bank whose qualifications as a depository have been determined by the person or authority designating it. In this circumstance, the duty to deposit in a bank qualified, excludes a duty to determine condition and stability. This does not mean that liability would not accrue to the surety if the trustee or receiver was careless in such matters as depositing funds to a wrong account or issuing a check to a wrong person.

In *State* v. *Bowers,* 26 Oh. Cir. Ct. 326, aff'd. 70 Oh. St. 423, 72 N. E. 1155, the construction of a statute exonerating an officer from liability for loss of funds deposited in a designated depository, was before the court. The language of the statute granted relief from liability for such loss except in the case of default or neglect. The officer there refused to make deposits in the depository on the ground

that the exonerating statute afforded him no protection because it expressly reserved liability in the case of neglect. His position was that if he were to be held responsible in the event of a failure to exercise due care and caution for the safekeeping of the funds in making and maintaining deposits he should have authority to deposit them where he believed them most secure and not in a designated depository. The court held that the reservation in the event of neglect had no application to a duty of care with respect to the bank selected or the amount of its security but merely to the manner in which the officer dealt with the deposits after they had been placed in the depository; that the neglect referred to in the statute had no application to the solvency or stability of the bank but to the exercise of the officer's disbursing power. The court said:

> "If the treasurer deposits the public funds according to the ordinance of the city council and they are lost, he is not to be held liable unless his carelessness has contributed thereto; the carelessness contemplated is not related to the propriety of the ordinance or the care of the bank selected, or its bond, but the manner of dealing with its deposits after they are so made. If the treasurer should, by carelessness, give an order on the bank to the wrong person, or for the wrong amount, and the order is paid, in such case he is to be held responsible."

In *City of Newburgh* v. *Dickey,* 150 N. Y. S. 175, 178, 164 App. Div. 791, mandamus was brought against a city treasurer who refused to deposit city moneys in a designated depository on the ground that he might be held liable for moneys lost if the depository failed. In ordering the writ, the court said:

> "And the bond prescribed is that such officers shall 'faithfully discharge the duties of their respective

offices, and pay over all moneys received by them, respectively'. * * * The defendant's argument is that since he is required to give a bond and is thus responsible, the fair intendment is that he should select the depository. * * * Neither the requirement of this bond nor the general rule would extend to moneys received by the official, while those moneys were held by a depository designated by another body or officer of the city in accord with law and exclusive of any power cast upon him. * * * The condition of the bond would be met if he discharged his duty with respect to the moneys when not in the exclusive charge of the depository * * *."

What petitioners are really seeking is not a construction of the provision of the Bankruptcy Act prescribing the official duty to deposit in a designated depository but an expansion of the duties enumerated in the Act. In substance, they ask that by judicial construction there be read into the statute a duty on the trustee or receiver to determine the qualifications of the designated depository, a duty whose performance it then could be contended required due care. Such duty, however, was not provided. That it will not be imposed by law is clear from the depository system prevailing in bankruptcy.

II.

UNDER THE DEPOSITARY SYSTEM ESTABLISHED BY THE BANKRUPTCY ACT FOR ASSURING THE SAFETY OF BANKRUPTCY FUNDS COMING INTO THE POSSESSION OF TRUSTEES AND RECEIVERS, NO DUTY IS OWED BY THE TRUSTEE OR RECEIVER WHEN MAKING OR MAINTAINING DEPOSITS OF FUNDS IN A DESIGNATED DEPOSITORY OF THE BANKRUPTCY COURT, TO DETERMINE WITH CARE THE CONDITION OR STABILITY OF THE DEPOSITORY.

In concluding heretofore that the condition of the bonds requiring Howard to account, interpreted as meaning to make disposition in accordance with law, had been met by his deposit of the funds in a designated depository, it was suggested, p. 27, *supra*, that some question might arise as to whether a disposition in accordance with law involved not only his making and maintaining the deposit in a designated depository but his judging, with care, of the condition and stability of the depository. This question already has been considered in the discussion above concerning the various official duties imposed by the Bankruptcy Act and General Orders upon the trustee or receiver with respect to his handling of bankruptcy funds coming into his possession. In the enumeration of such duties no provision was made that the officer in making or maintaining the deposit should consider, with care, the qualification, condition or stability of the designated depository. However not only has the Bankruptcy Act failed so to provide; under the depository system which it set up the supposed duty does not exist.

A.

Responsibility of Fiduciaries and Public or Quasi-public Officers for Funds Placed in Their Custody and Lost in a Bank Failure.

The case presented concerns liability for bankrupt estate funds which were deposited in a designated depository of the bankruptcy court and were lost when the depository closed its doors. The case should be distinguished from cases in which the bankruptcy funds involved were never deposited in any bank, depository or otherwise, or if deposited, were not deposited in a designated depository. Undoubtedly, in such cases liability on the official bond arises if the funds are lost, and, indeed, arises without regard to whether negligence is present. In the case before the Court, the funds were concededly on deposit in one of the regular designated depositories of the bankruptcy court and were so on deposit when the depository ceased doing business.

The books contain literally hundreds of cases in which courts have passed upon the responsibility of fiduciaries and public and quasi-public officers for funds placed in their custody and lost on some bank failure. These cases divide themselves into three classes according to the rule of responsibility applied.

In the first class the rule is one of absolute liability. It is limited in application to public officers and holds them strictly liable as insurers for whatever loss may occur. Due care and good faith are immaterial, *Mecklenberg County* v. *Beales, Treasurer*, 111 Va. 691, 69 S. E. 1032, 36 L. R. A. (N. S.) 285; *Town of Cameron* v. *Hicks*, 65 W. Va. 484, 64 S. E. 832, 17 Ann. Cas. 926. In none of these decisions, however, was the court concerned with a depository system of the kind hereinafter described.

In the second class, the rule of ordinary care and prudence is followed. Here, the common law fiduciary or the public or quasi-public official is held liable only in the event of a failure to exercise ordinary care and prudence as to the safety of the bank when making or maintaining deposits. Common law trustees, *Barney* v. *Saunders*, 57 U. S. (16 How.) 535; *Anguera* v. *Yturria*, 80 F. (2d) 57 (C. C. A. 5); *Carey* v. *Safe Deposit & Trust Co. of Baltimore*, 168 Md. 501, 178 Atl. 242, equity receivers, *Neff* v. *Harmon*, 145 Okla. 114, 291 Pac. 518, assignees for the benefit of creditors, *In re Stone's Assignment*, 220 Ia. 1341, 264 N. W. 604, executors, *In re Kohler's Estate*, 15 Wash. 613, 47 Pac. 30; *In re Workman's Estate*, 196 Ia. 1108, 196 N. W. 35, administrators, *Hart* v. *Savary*, 114 Fla. 41, 152 So. 705; *In re Olson's Estate*, 206 Ia. 706, 219 N. W. 401; *Harper* v. *Betts*, 177 Ark. 977, 8 S. W. (2d) 464, and guardians, *In re Welch's Estate*, 100 Mont. 47, 45 Pac. (2d) 681, are held liable for estate funds lost in a closed bank only if they have failed in such duty. In this class, likewise, are found those cases of public officers in which the courts refuse to apply the strict rule and merely hold them liable for a failure to exercise due care and prudence, *Wilson* v. *People*, 19 Colo. 199, 34 Pac. 944, involving a clerk of court; *State* v. *Copeland*, 96 Tenn. 296, 34 S. W. 427, town trustee; *Town of Danbury* v. *Riedmiller*, 208 Ia. 879, 226 N. W. 159, town treasurer; *State* v. *Gramm*, 7 Wyo. 329, 52 Pac. 633, 40 L. R. A. 690, state treasurer. As with the first class of cases none of the above decisions concerns itself with a depository system of the kind hereinafter described.

In the third class, the fiduciary or depositing officer is not held responsible for funds lost on deposit. Unlike the cases falling in either the first or second class, each of the cases in the third class involves some depository sys-

tem set up by statute for the administration and safekeeping of the funds pending disbursement, payment or distribution. While the systems vary in structure—depository systems not only differ among jurisdictions but in the same jurisdiction—it is characteristic of all these systems that they divide authority over the funds while in safekeeping among different persons. The extent of discretion and control over funds which the officer or fiduciary in the first two classes of cases exercised is not enjoyed by the depositing fiduciary or officer.

The principle underlying the systems is essentially that of checks and balances, and as carried out structurally involves the following features: (a) the fiduciary or officer who receives the funds and who generally is vested with all or some amount of the disbursing power is not permitted to retain the funds in his own possession during the period of safekeeping or exercise any general discretion as to the place where they are to be kept; (b) he is required to deposit the funds in a depository designated for that purpose and can make no deposits of, nor can he place, the funds elsewhere; (c) the power to designate and supervise such depository, to revoke its designation and designate new depositories, is lodged with a person or body other than the fiduciary or officer. By such a division of authority not only is risk of loss, through the insolvency of some person, minimized, but likewise the possibility of unlawful use of the funds or other mishandling. It is not intended to suggest by what has been said that the only checks and balances to be found in depository systems are the three above stated. Some systems are quite elaborate in this respect. However, in all of the cases of the class here considered, these three are common to the systems involved, and are held to be essential in determining whether the depositing fiduciary or officer is relieved in law from responsibility for funds lost while on deposit.

The requirement that the fiduciary or officer promptly deposit the funds in a depository chosen for such purpose by the designating authority and the consequent shifting away from him of the power or discretion to select and designate the depository, form the basis upon which the courts hold that the legislative intent was to impose no liability upon the depositing fiduciary or officer in the event of loss through a closing of the depository. The decisions point out that where the stated features appear and his discretion is thus limited, the fiduciary or officer was not intended to be an insurer of the funds, and what an ordinary prudent person might have done with his own moneys in depositing them in the depository is wholly irrelevant. On the other hand, where some of the features are not present, as where the depositing officer is required by statute to deposit the funds in a bank but has authority to designate what bank shall act as depository, it is held that the legislative intent was not to relieve the depositing fiduciary or officer from responsibility for the loss, *State* v. *Bobleter,* 83 Minn. 479, 86 N. W. 461.

A depository system is provided for funds administered in bankruptcy. This system will be considered before the decisions in the third class of cases are examined.

B.

The Depository System in Bankruptcy.

Under the Bankruptcy Act and General Orders, the safekeeping of bankruptcy funds is governed by a well-fashioned depository system. Safety and proper custodianship are sought not in individuals but in an administrative system. Checks and balances are present and duties and relationships defined.

1.

THE TRUSTEE OR RECEIVER IN BANKRUPTCY AND HIS DUTIES WITH RESPECT TO FUNDS COMING INTO HIS POSSESSION FOR SAFEKEEPING.

Trustees and receivers in bankruptcy are statutory officers, *United States* v. *Union Sur. & Guar. Co.*, 118 Fed. 482, 486 (D. C. N. Y.); *Bingaman* v. *Commonwealth Trust Co.*, 1 F. (2d) 505, 506 (D. C. Pa.); *Meehan* v. *King*, 54 (2d) 761, 763 (C. C. A. 1). Section 33 of the Act (11 U. S. C. A. 61) states expressly that the office of trustee is created, pursuant to the provision of the statute, and General Order XL (11 U. S. C. A. 53) defines the office of receiver as that of a custodian within the meaning of Section 48 of the Act. The name "trustee" or "receiver" does not connote its common law usage. Petitioner's argument in several places of their brief confuses the obligations of the common law fiduciary with that of the bankruptcy officers. As was said in *Imperial Assurance Co.* v. *Livingston*, 49 F. (2d) 745, 748 (C. C. A. 8):

> "In framing the machinery to work out the purposes of the Bankruptcy Act, Congress made use of terms (such as referee, trustee, receiver) which were taken from the body of the general law * * *. But the importations were of terms or names rather than of definitions; for example, referee in bankruptcy does not mean an officer with the same powers and duties as a referee in equity, and the same is true of trustees and receivers in bankruptcy. * * * Resort must first be had to the act in order to ascertain, through the definition therein of powers and duties, the real meaning of the terms used therein."

While the provisions of the Act and general orders relating to the safekeeping of bankrupt estate funds do not

expressly apply to receivers, it is well settled that the duties of receivers in this respect are the same as those of trustees, *R. J. Reynolds Tobacco Co.* v. *A. B. Jones Co.*, 54 F. (2d) 329, 335 (C. C. A. 8).

Trustees and receivers are depositing officers. They are required to "deposit all money received by them in one of the designated depositories," Section 47 (a)(3) of the Bankruptcy Act (11 U. S. C. A. 75 (a)(3)). This duty is mandatory, *In re Potell*, 53 F. (2d) 877, 879, (D. C. N. Y.); *In re Hoyt*, 119 Fed. 987, 988 (D. C. N. C.); *In re Kyle*, 181 Fed. 617, 621 (C. C. D. Mass.); *Huttig Mfg. Co.* v. *Edwards*, 160 Fed. 619, 622-623 (C. C. A. 8); *R. J. Reynolds Tobacco Co.* v. *A. B. Jones Co.*, 54 F. (2d) 329, 335 (C. C. A. 8). As one text-writer in speaking of the duties of such officer under Section 47(a)(3) said, "He is given no discretion in the matter, and ordinarily it is not proper for him to deposit any of the funds in any other bank even temporarily," that he "should, therefore, deposit in the designated depository all funds which come into his possession as soon as possible after they are received," A. S. Woodman, *A Treatise in the Law of Trustees in Bankruptcy*, Boston, Little, Brown & Company, 1909, p. 51, sec. 35(a). Thus, depositing estate funds in a bank will not save the deposit from being unlawful if the bank is not a designated depository, *In re Potell*, 53 F. (2d) 877 (D. C. N. Y.); *In re Hoyt*, 119 Fed. 987 (D. C. N. C.). Nor will an order by the district court in bankruptcy specifically directing that the deposit be made in a non-designated bank render the deposit any the less illegal, *Huttig Mfg. Co.* v. *Edwards*, 160 Fed. 619, 622 (C. C. A. 8); *R. J. Reynolds Tobacco Co.* v. *A. B. Jones Co.*, 54 F. (2d) 329 (C. C. A. 8). Similarly, a disbursement by the trustee or receiver out of funds in his possession, without first depositing the funds in a designated depository and then making the disbursement,

is improper, *In re Hoyt & Mitchell,* 127 Fed. 968 (D. C. N. C.); *In re Kyle,* 181 Fed. 617 (C. C. D. Mass.). On the other hand, there is no need for the trustee or receiver, before depositing in a designated depository, to secure an order directing the same, *In re Singer Furniture Corp.,* 47 F. (2d) 780, 783 (D. C. N. Y.).

The trustee or receiver is obliged to determine whether the particular banking institution in which he proposes to make deposits is a designated depository. This he can do by examining the formal order of designation required by statute, Section 61 of the Bankruptcy Act (11 U. S. C. A. 101). The mere fact that a bank may have given a depository bond as required by statute does not make it a designated depository if no order of designation has been entered in the bankruptcy court, *In re Ocean City Title & Trust Co.'s Bond,* 6 F. Supp. 311 (D. C. N. J.). Where the order of designation places some restriction upon the making of deposits, as a limitation upon deposits in excess of a stated amount, the trustee or receiver is expected to observe such restriction. However, if the order is a general order, the trustee or receiver is free to make deposits without particular restraint. In *Illinois Surety Co.* v. *United States,* 226 Fed. 665, 667 (C. C. A. 7), the court refused to hold that upon the failure of a depository, those depositors who had made deposits after the deposits of others had equalled the penal sum of the depository bond, could not share in the proceeds of the bond, saying:

> "In support of the first contention, it is urged that, as the court [district court in bankruptcy] may from time to time order an increase in the amount of the bond [given by the designated depository to assure against loss of bankrupt estate funds], every depositor, before making his deposit, must ascertain whether the amounts then owing might exhaust the penalty,

and, in that event, he must see to it that an increase of the bond is ordered, if he desire to share in the protection.

The statement of the proposition carries its own refutation. No such limitation is expressed in, and none assuredly will be implied from, the language either of the statute or of the bond itself." (Words in brackets added.)

Trustees, and consequently receivers, as depositing officers, are required within the first month after appointment and every two months thereafter, to make and file reports with the district court in bankruptcy showing the amount of bankrupt estate funds on hand and what other information the court shall require, Sec. 47 (a) (10) of the Bankruptcy Act, (11 U. S. C. A. 75 (a) (10)). The district court, as hereinafter stated, occupies the position of the designating and administrative authority in the depository system provided by the Act.

Bankruptcy funds in the possession of a trustee or receiver pending deposit in a designated depository are not private funds but funds in *custodia legis* subject to administration under the Constitution and laws of the United States, *In re Ocean City Title & Trust Co.'s Bond,* 6 F. Supp. 311 (D. C. N. J.). While pending deposit of the funds, the receiver has custody and the trustee title thereof; after deposit in a designated depository identity of the funds ceases and they become simple contract claims against the bank, *Gardner* v. *Chicago Title & Trust Co.,* 261 U. S. 453. Petitioners' brief, pp. 34, 39, refers to the title of the trustee in funds prior to deposit as though it were the full title of a common law fiduciary. The title of the trustee, however, is a limited one, *Imperial Assurance Co.* v. *Livingston,* 49 F. (2d) 745, 749 (C. C. A. 8). The

reference in petitioners' brief, pp. 12, 34, 39, 43, to bankruptcy funds as "private funds" or "private moneys" is a loose one. The cases cited in connection therewith, p. 39, merely hold that a bankrupt estate is a general and not preferred creditor of a depository which has failed. Public moneys on deposit in a designated depository likewise represent only general claims in the event of a failure of the bank, *Potter* v. *Fidelity & Deposit Co.*, 101 Miss. 823, 58 So. 713, 715; *City of Parsons* v. *Fidelity & Deposit Co.*, 29 F. (2d) 417, 423 (D. C. Kan.), reversed on other grounds 43 F. (2d) 315 (C. C. A. 10).

Trustees and receivers are not merely depositing officers; they also make disbursements. However, their power to disburse is limited by the Act and General Orders. Disbursements cannot be made out of funds in possession but must be made from funds on deposit, *In re Hoyt & Mitchell*, 127 Fed. 968 (D. C. N. Car.); *In re Kyle*, 181 Fed. 617 (C. C. Mass.). Section 47(a)(4) of the Act (11 U. S. C. A. 75 (a)(4)) provides that disbursements of funds on deposit may be made "only by check or draft" on the depository. General Order No. 29 (11 U. S. C. A. 53) provides that "No moneys deposited as required by the act shall be drawn from the depository unless by check or warrant, countersigned by the judge of the court, or by a referee designated for that purpose, or by the clerk (of the court) or his assistant under an order made by the judge * * *." These requirements are likewise mandatory, *Huttig Mfg. Co.* v. *Edwards*, 160 Fed. 619, 622-623 (C. C. A. 8); *In re Hoyt*, 119 Fed. 987, 988 (D. C. N. Car.). In some districts it has been held that these provisions prevent the trustee or receiver from making deposits in his name as such officer, but require the deposits to be made in the name of the bankruptcy court, *In re Cobb*, 112 Fed. 655 (D. C. N. Car.).

2.

THE BANKRUPTCY COURT AS THE DESIGNATING AND ADMINISTRATIVE AUTHORITY.

The district court in bankruptcy has absolute authority over the designation and supervision of depositories for bankruptcy funds, Section 61 of the Act (11 U. S. C. A. 101). Exclusive discretion and power are given it to select among banking institutions and designate those which are to act as depositories. No restriction is placed by the Act upon the terms which may be required as a condition to designation except that a depository bond payable to the United States shall be furnished, *ibid.* The amount of the bond is left to the approval of the court, and it may from time to time increase the amount thereof, *ibid.* Such depository bonds are required to be filed of record in the office of the clerk of the court, Sec. 50(h) of the Act (11 U. S. C. A. 78(h)). The court has full power to change the depository and appoint new ones as the occasion may require. It may, by order, limit the amount of bankruptcy deposits which a depository may accept to the penal sum of its depository bond. Recently, under General Order LIII, the duties of the court with respect to depository bonds have been more specifically defined.

The court in designating and supervising depositories acts principally in an administrative rather than judicial capacity, see discussion, *Board of Finance* v. *First National Bank,* 71 Ind. App. 290, 124 N. E. 768. It employs summary orders, *In re Howard,* 130 Fed. 1004 (D. C. Cal.); *In re Ocean City Title & Trust Co.'s Bond,* 6 F. Supp. 311 (D. C. N. J.); *In re Potell,* 53 F. (2d) 877 (D. C. N. Y.); requires reports from trustees, receivers and depositories, Section 47(a)(10) of the Bankruptcy Act (11 U. S. C. A. 75(a)(10)); countersigns all checks drawn on depositories,

General Order No. 29 (11 U. S. C. A. 53); and follows a characteristically non-judicial procedure (see R. 148, 173). In relating the practice of bankruptcy courts in designating depositories, it has been said, "Usually the designation of depositories is made by a standing order of court and numerous depositories are appointed within the district. It is not customary for the court to make a special order designating a special depository for the funds of a particular case and when no special depository is designated the trustee will usually be permitted to make use of the depository most convenient to his place of residence," A. S. Woodman, op. cit. p. 51.

3.

THE DESIGNATED DEPOSITORY AND FUNDS IN ITS POSSESSION.

The position of the designated depository in the system sufficiently appears from what has above been stated. So far as receiving bankrupt estate funds, its conduct is controlled by the order of designation, other orders made by the bankruptcy court, and general law. It is amenable to summary order. Designated depositories are themselves officers of the court, *State of Kansas* v. *U. S. Fid. & Guar. Co.*, 81 Kan. 660, 106 Pac. 1040, 26 L. R. A. (N. S.) 865; *State* v. *U. S. Fid. & Guar. Co.*, 210 Wis. 178, 246 N. W. 434; *Miller* v. *Batson*, 160 Miss. 642, 134 So. 567; *Perkins* v. *State*, 130 Miss. 512, 94 So. 460; *Board of County Comm'rs.* v. *Mason*, 38 Wyo. 1, 264 Pac. 93. Funds deposited with the depository are withdrawn from *custodid legis* and become simple debts of the bank, *Gardner* v. *Chicago Title & Trust Co.*, 261 U. S. 453; compare *Potter* v. *Fidelity & Deposit Co.*, 101 Miss. 823, 58 So. 713; *City of Parsons* v. *Fidelity & Deposit Co.*, 29 F. (2d) 417 (D. C. Kan.), rev'd. on other grounds 43 F. (2d) 315 (C. C. A. 10); *In re State Treasurer's Settlement*, 51 Neb. 116, 70

N. W. 532, 537. The depository is responsible for any loss which may arise if it permits a receiver or trustee to withdraw bankruptcy funds by a check that is not countersigned by the bankruptcy court, *In re Singer Furniture Corp.*, 47 F. (2d) 780 (D. C. N. Y.).

In England and Canada bankruptcy funds are handled through a depository system similar to that existing under federal law, *Williams Bankruptcy Practice*, 14th ed., London, 1932, p. 395; *Bankruptcy in Canada*, Duncan and Reilley, 2d ed., Canadian Legal Authors, Ltd., p. 373.

C.

A Fiduciary or Public or Quasi-Public Officer Who Deposits Funds Under a Depository System, is not Liable for Their Loss Through a Closing of the Designated Depository.

The depository system in bankruptcy is similar in its essential features to the systems involved in the third class of cases above mentioned, pp. 38-40, where the rule of non-responsibility was applied.

In *Town of Hamden* v. *American Surety Company of New York*, 9 F. Supp. 733 (D. C. Conn.), the court discussed the federal depository system provided by the Acts of Congress, and, in comparing it with the local depository system there under review, said, p. 738:

> "• • • under the federal system although 'all public officers of whatsoever character, are required to keep safely, without loaning, using, depositing in banks • • • all the public money collected by them, or otherwise at any time placed in their possession and custody' (31 U. S. C. A. Sec. 521), at the same time the federal law affirmatively requires every disbursing officer (31 U. S. C. A. Sec. 492), and indeed

'every person who shall have moneys of the United States in his hands or possession' (31 U. S. C. A. Sec. 495), to deposit the same with or pay the same to 'the Treasurer or a depositary of the United States'; the same to be designated in conformity with 31 U. S. C. A. Sec. 476. This latter statute, together with 12 U. S. C. A. Secs. 391 and 392, to which it refers, authorizes the Secretary of the Treasury to designate any of the Federal Reserve Banks as depositories and fiscal agents of the United States. And as such depositories, they may be required to give security for the public funds received. 12 U. S. C. A. Sec. 90.

It thus is inherent in the federal system that federal funds coming into the hands of a receiving officer, when once deposited with a duly designated depository of the United States, are in effect in the treasury of the United States and hence no longer in the possession or custody of that receiving officer. See *Branch* v. *U. S.*, 100 U. S. 673, 25 L. Ed. 759. And the same situation exists with reference to public funds on deposit with a federal depository awaiting disbursement by any official disbursing officer. Thus, in the ordinary case no question can arise as to the liability of a federal receiver of public moneys or of a federal disbursing officer, for funds deposited with a duly designated depository.'"*

Petitioners' brief, pp. 30-31; refers to several decisions of this Court in which a public officer was held liable

*The secretary of treasury of the United States may designate national banks as federal depositories, 12 U. S. C. A. 90, and banks so designated are required to make annual reports to the secretary concerning federal moneys deposited with them, 31 U. S. C. A. 153.

under the insurer rule (p. 37, *supra*) for a loss of funds in his possession as officer. These decisions involved no deposit in a bank whether a designated depository or otherwise.

The necessity for examining the character of administrative system set up, when determining the responsibility of the fiscal officer, was commented on in *Town of Hamden* v. *American Surety Co., supra,* as follows, pp. 738-739:

> "Necessarily the liability of such an official will depend on state statutes, if such exist; and in the absence of statute, on the common law of the state which in large measure must be deduced from the administrative system of the state.
>
> Indeed, this underlying principle that the liability of a state official depends upon the local law is the source of much of the confusion on the subject-matter. For the many variations in the administrative systems of the several states necessarily lead to different conclusions as to their respective policies; in some states, as in the federal government, the statutory structure of administration is such as to compel the conclusion that the common-law liability of a public custodian has been impliedly modified; in others no such conclusion is justified."

In *City of Scranton, Pa.* v. *Aetna Casualty & Surety Co.*, 11 F. Supp. 986 (D. C. Pa.) the surety company was sued on the official bond of a city treasurer conditioned upon the faithful performance of his official duties and his turning over to the city at the end of his term of office all city property coming into his possession. The complaint charged that the bond had been broken by the failure of the treasurer to pay over at the end of his term moneys which had come into his hands as treas-

urer. The defendant pleaded that the moneys had been deposited in two banks duly designated by the city council as depositories for city funds, that these moneys never again came into his possession and that they had been lost in a closing of the banks. Under Pennsylvania statutes, city treasurers were required to deposit city funds in banks designated as depositories by the council, to make disbursements only by warrant countersigned by the city controller, and to make daily reports to the controller of all receipts, deposits and withdrawals of such funds. The court held the defense sufficient in law, saying, pp. 988, 989:

> "The treasurer's duty to deposit daily the receipts of his office in banks selected by council is a mandatory requirement not contained in any acts under which treasurers and collectors have been held to be responsible for public moneys coming into their hands, and that feature distinguishes the case at bar from those cases where it has been held that the treasurer is an insurer. * * * In *Hinton* v. *State of Oklahoma*, 57 Okl. 777, 156 P. 161, 163, it was held: 'It is well settled by authority and on principle that, when such depositories have been designated according to law, neither the county treasurer nor his bondsmen are liable for the loss of funds deposited therein, so long as the treasurer keeps within the requirements of the law.' * * *
>
> The plaintiff contends that the city treasurer cannot be released from liability in the absence of an expressed provision in the statute that a compliance with the act will relieve him from such liability. With this contention I cannot agree. Such expressed provision is not necessary to accomplish the same result.

In *Edgerton Independent Consol. School District v. Volz*, 50 S. D. 107, 208 N. W. 576, 578, the court said: 'It is clear, upon principle and authority, that, if the school district had been authorized to designate, and had designated, said bank as the depositary, then the failure of the bank would have relieved the treasurer from liability for the amount on deposit. In many depositary acts in this and other states it is expressly provided that a compliance with the act will relieve the treasurer from such liability, but such express provision is not necessary to accomplish the same result.' * * *

The contention of the plaintiff is without precedent in Pennsylvania. The state did not make it the duty of treasurers * * * to deposit the public moneys in banks selected by city council, and, at the same time, impose losses due to failures of the depositories upon the treasurers."

In *American Surety Co. of New York* v. *City of Thomasville*, 73 F. (2d) 584 (C. C. A. 5), suit was brought by the city against a surety on its treasurer's official bond to recover the amount of city funds deposited by the treasurer in three banks which failed in the years 1932 and 1933. The bond was conditioned upon the faithful discharge by the treasurer of his official duties. The city ordinances provided that the treasurer was to receipt for, keep and pay out city funds "as authorized by" the city council, and directed the treasurer to make deposits in the three banks designated as depositories therefor. The Circuit Court of Appeals for the Fifth Circuit in reversing a judgment on a verdict directed below for the city, said, pp. 586, 587:

"In Georgia, as generally elsewhere, it is held that a public official intrusted with public moneys is bound

to keep them safely at all events, and is not excused for losses unless perhaps when caused by the act of God or the public enemy. * * * It must be, however, that, if by competent authority public funds are authorized or required to be deposited at a particular place or on particular terms, the official holding them will be protected in so dealing with them. It is no possible breach of duty for him to do so. In Georgia, since 1879, under legislative authority banks have been designated by the Governor to act as depositories of the state's funds. * * * Since then such depositories have been quite commonly authorized and used; the public funds in most cases drawing interest as for a loan while on deposit. In 1933 * * * all public officers were required to deposit public funds in public depositories. It is thus evident that for many years the public policy of the state in this regard has been changing. The original idea of making the official the only custodian of the funds has been yielding to the idea of using them to make interest by depositing them in solvent banks under such safeguards as might be thought necessary.

That what the Legislature itself directs is a protection to an obedient officer no one would question. * * * By so depositing * * * [the moneys in the designated depositories] the treasurer cannot be said to have done contrary to his duty or to have breached a bond conditioned for the faithful performance of it." (words in brackets added)

In the early case of *Perley* v. *County of Muskegon*, 32 Mich. 132, 135, the Supreme Court of Michigan discussed the rule as follows:

"The position of a public officer is peculiar, and the differences in different systems of statutes show

that the responsibility is not by any means uniform. * * * The usual rule in regard to bailments exonerates the bailee who has done all that was in his power to prevent loss or accident, and there are authorities which on this ground discharge public treasurers from any greater liability. There are others which hold them to be debtors, and not bailees, and not exonerated under any circumstances.

* * * If an officer is required or authorized by law to make deposits in any particular place or with any particular person, he is usually, if not universally, protected from any further responsibility, so long as he leaves it there."

In *Board of Education* v. *Nelson,* 33 N. D. 462, 157 N. W. 664, 665, 666, 667, the treasurer of a school district and his sureties were sued on his official bond to recover school moneys deposited in one of the depositories designated by the board and lost when the depository failed. The amount deposited was in excess of a depository bond furnished by the depository. The Supreme Court of North Dakota held that the treasurer and his sureties were not liable, saying:

"By chapter 105 of the Session Laws of 1905 a complete and comprehensive depositary plan was enacted. * * * Instead of the old relationship of liability of the official to the municipality, the Legislature has seen fit to declare it to be the better policy to substitute a relation of debtor and creditor as between the bank and the municipality. By section 1481, C. L. 1913:

'All funds of the city or school district shall be deposited in the name of the city or school district by the city treasurer or treasurer of the school district,

as soon as received by him, in such bank or banks as shall have been designated as city or school district depositaries.'

* * * Section 1484 provides that:

'All checks drawn upon the city or school district depositaries shall be signed by the city or school district treasurer in the name of the city or school district, by himself as treasurer.'

* * * If this money has been deposited in a depositary, the school district has, in the language of the opinion in *Re State Treasurer's Settlement,* 51 Neb. 116, 70 N. W. 532, 36 L. R. A. 746, in legal effect made—

'a loan of such moneys to the bank, and the relation of debtor and creditor is thereby created, not between the bank and the treasurer, but between the former and the * * * (school district), since the money thus deposited belonged to the * * * (school district), and not to the treasurer, its agent and representative. * * *'

* * * And of course the Legislature has plenary power to prescribe the liability of its officials for the funds of it or its municipalities. The state could not elect to loan its money, or that of its municipality, to a bank, as here done, under the depositary law, and compel the treasurer, as its representative, under criminal penalties to create such relationship, he having no voice in the selection of the depositary, and at the same time hold him as an insurer of the state's debtor, the bank. * * * The state has * * * chosen to depart from any absolute or limited theory of the officer as insurer, and has substituted therefor the liability of its depositary, assuming rather to take

the risk of the latter than of the official as to ability to respond for public funds. * * *

* * * The responsibility rested, not with the treasurer, but with the board, when the former followed the written orders of the latter. * * *

It is not the treasurer's duty to select depositaries, but instead to comply with the orders of the board to deposit where that body having the power to designate depositaries has directed the deposit to be made. * * * Neither the power nor the resulting responsibility to designate can be divided between the treasurer and the board, and it is not so divided by statute. * * *

The duty to require additional [depository] bonds was upon the board. * * * The responsibility for the loss is not with the defendant treasurer, as he had no option in the matter but to comply with the orders of the board. * * * The defendant had the right to presume that the school board had performed its duties." (word in brackets added)

In *Benson* v. *American Surety Co. of N. Y.*, (Minn. 1937) 271 N. W. 125, 126, recovery was sought of the city treasurer for city funds lost in a failure of the designated depository. The city charter exempted the sureties on the treasurer's bond in the event of a loss of funds through such failure, but was silent on the liability of the treasurer. In holding the treasurer not liable, the court said:

"True, this provision of the charter does not, in specific language, absolve the city treasurer from liability for funds deposited in designated depository banks pursuant to the said charter provision, but it stands to reason that when the treasurer has parted

with the possession and custody of the funds in obedience to law he should no longer be responsible for the same."

In several cases, the question of whether the depositing officer is required to determine the condition or stability of a depository bank has come before the court in a challenge by the officer of the designating authority's power to compel him to deposit in a bank other than one of his own choice. In *Stephens* v. *City of Ludlow,* 159 Ky. 729, 169 S. W. 473, 475, the city treasurer filed a petition to enjoin the city council from enforcing an ordinance requiring him to deposit city funds in a depository designated by the council. The treasurer contended that under state statute he was responsible for their safekeeping and should have the discretion where deposits should be made. The Kentucky Court of Appeals affirmed a judgment below which sustained demurrer to the petition, saying:

"* * * There would, of course, be great force in this argument if the treasurer were an insurer of the solvency of the depository selected by the city, but he is not. * * * when * * * the selection of the depository is taken out of his hands, and he is directed by the city to keep its funds in an institution selected by it, the city, and not the treasurer, assumes responsibility for the integrity and solvency of the institution so selected." * * *

Under like circumstances, it was said in *Magee* v. *Bristow,* 109 Miss. 183, 68 So. 77, 78:

"It will be sufficient to say that this [depository] law has also materially modified the duties of county treasurers * * * and no liability growing out of the receipt and disbursement of county funds can attach

to a county treasurer who has complied with the provisions of the depository law." (word in brackets added)

And in *Board of Finance* v. *First National Bank*, 71 Ind. App. 290, 124 N. E. 768, 771-772, the court stated:

"When the judge of the Circuit Court [designating authority] approved the bond and designated the bank a depository, the Board of Finance [depositing officer] was * * * relieved." (words in brackets added)

The opinion in this case comments on activity of the court as a designating authority in the following words, p. 770-771:

"But judges do not always act in their judicial capacity. It seems that the Legislature is permitted to call upon judges to perform acts which are not judicial, but which are purely ministerial, executive or administrative * * *.

We are of the opinion that the Legislature did not intend that [when the court acted, in designating a depository] there should be an adversary proceeding under the code, requiring issues, trial, finding and judgment; and did not intend that this function should be performed by the judge in his judicial capacity. What is presented to the judge is more in the matter of a business proposition than a civil action." (words in brackets added)

Also: *City of New Haven* v. *Fresenius*, 75 Conn. 145, 52 Atl. 823, 825; *Joint School District No. 105* v. *First National Bank*, 125 Okla. 243, 257 Pac. 318, 319; *Miller* v. *Batson*, 160 Miss. 642, 134 So. 567, 572; *City of Newburgh* v. *Dickey*, 150 N. Y. S. 175, 178, 164 App. Div. 791.

In some jurisdictions the rule announced in the above cases has found its way into an express statutory provision of exoneration, *State* v. *Bowers*, 26 Oh. Cir. Ct. 326, aff'd. 70 Oh. St. 423, 72 N. E. 1155. However, express statutory exoneration is unnecessary. See particularly *City of Scranton, Pa.* v. *Aetna Casualty & Surety Co., supra*, 11 F. Supp. 986, 988 (D. C. Pa.).

Petitioner's brief, p. 21, cites *Jordon* v. *Baker*, 252 Ky. 40, 66 S. W. (2d) 84; *Edwards* v. *Logan County*, 244 Ky. 296, 50 S. W. (2d) 83; and *State* v. *McNamer*, 62 Mont. 490, 205 Pac. 951, as supporting the proposition that an official required by statute to deposit in a particular depository, may, nevertheless, be held responsible for funds lost in the closing of the depository. In the *Jordon* case, it was held that mandamus would lie to compel the issuance of a quietus to a fiscal officer who had deposited county funds in a designated depository which failed, and that decisions applying the insurer's rule would not be followed. By way of *dictum*, it was suggested that knowledge in the officer warranting him taking action with respect to deposits might amount to "that degree of negligence" rendering him liable as a bailee. Three months after the *Jordon* case was decided, the Kentucky legislature enacted into legislation, Ky. Acts, 1934, c. 22, the general rule of non-responsibility which the Kentucky court in the earlier case of *Stephens* v. *City of Ludlow*, p. 57 *supra*, 159 Ky. 729, 169 S. W. 473, had announced. The *Edwards* case was concerned with a judgment below based upon the insurer's liability rule. On appeal, the judgment was reversed for new trial, the court pointing out that when the bank was designated a depository and the officer was directed to deposit the funds there and he obeyed, the designating authority "assumed responsibility for the integrity and solvency of the institution and exonerated him from loss of funds

if suffered solely on that account," *ibid,* 50 S. W. (2d) p. 86. *State* v. *McNamer,* 62 Mont. 490, 205 Pac. 951, held that where the county collector was under duty to pay over city funds to the city treasurer as promptly as they were computed but failed to do so, and instead permitted them to remain on deposit in a designated depository, liability for his failure to make prompt turnover might be imposed, the court saying, p. 953:

> "If he deposits the city's money in the designated depository or depositories, and before he has had time to ascertain the amount he has collected for the city a loss occurs, such as in this case, he would no doubt be protected, but after the necessary time for making such computation elapses, to say that he would be relieved of the duty of paying over to the city such money so collected, would in a sense be allowing him to take advantage of his own wrongful conduct."

As a corrollary to the rule of non-responsibility, it is held that where a bond is required by law of the designated depository to secure deposits, the fiduciary or depositing officer is under no duty to inquire into the amount or sufficiency of such bond if the amount is fixed and terms approved by some one other than the fiduciary or depositing officer, *Town of Lakeland* v. *Ballmer,* 209 Wis. 636, 245 N. W. 682, 683; *Board of Education* v. *Nelson,* 33 N. D. 462, 157 N. W. 664, 667; *City of Billings* v. *Miss. Bonding & Ins. Co.,* 88 Mont. 91, 290 Pac. 246; see *City of Missoula* v. *Dick;* 76 Mont. 502, 248 Pac. 193, 195; *Illinois Surety Co.* v. *United States,* 226 Fed. 665, 667 (C. C. A. 7). Petitioners distinction, p. 28, of the *City of Billings* case as involving an express statutory exoneration is not wholly accurate. The exoneration clause involved contained no provision with respect to deposits in excess of the depository bond, and accordingly, the question was there raised and considered.

Petitioners' brief, pp. 36-37, cites seven cases, commencing with *State* v. *U. S. Fidelity & Guar. Co.*, 210 Wis. 178, 246 N. W. 434, in support of the proposition that "if the officer having charge of making deposits places larger sums in the depository [designated] than the amount of the depository bond", the officer is liable as an insurer for the amount deposited in excess of the depository bond. None of these cases supports such rule. *State* v. *U. S. Fidelity & Guar. Co., supra; Roberts County* v. *Wickard*, 53 S. D. 511, 221 N. W. 246; *Mass. Bonding & Ins. Co.* v. *Steele*, 125 Neb. 7, 248 N. W. 648, and *Board of Comrs.* v. *Soucek*, 128 Okla. 151, 261 Pac. 947, each was concerned with an express statutory provision limiting the amount of the deposits to a percentage of either the penal sum of the depository bond, or the capital of the bank, etc. In *State* v. *Carney*, 208 Ia. 133, 217 N. W. 472, and *Anderson* v. *Peterson State Bank*, 191 Minn. 404, 254 N. W. 459, a statute expressly provided that the penal sum of the depository bond should be in excess of deposits, and such provision was interpreted as prohibiting deposits in excess of the depository bond. *Cheyenne* v. *Maryland Casualty Co.*, 13 F. (2d) 401 (D. C. Wyo.) is without relevancy. Of course, neither the Bankruptcy Act nor General Orders contains any provision restricting bankruptcy deposits to the amount of the depository bond.

D.

Policy of the Rule in Bankruptcy.

It is evident that the depository system provided in the Bankruptcy Act for the safekeeping of bankruptcy funds is the same type of depository system which was involved in the third class of cases heretofore discussed where the rule of non-responsibility was applied to the depositing officer. The three essential features of that system are pres-

ent: the depositing officer cannot retain the funds in his possession or place them where he chooses; he must deposit them in a designated depository; the power to select and designate the depository, revoke the designation and approve a new depository, is lodged with another person. Indeed, the position occupied by the trustee or receiver in bankruptcy in relation to funds in safekeeping is much more servient. He is burdened with the duty of preparing and filing periodic reports to the designating authority of the amounts on deposit in the depositories; he is subject to summary order of the designating authority; his disbursing power can be exercised merely with respect to funds actually on deposit in the depository, and then, only by countersigned draft. This role is certainly different from that of the public officer who could, if he wished, put official funds in his own pocket and was held to an insurer's liability if the funds were lost in a bank failure, p. 37; or the common law fiduciary making deposits of the funds in such bank as he chose and withdrawing them at will, who was held liable for a loss if he failed to observe ordinary care and prudence for their safety, p. 38. The removal from the trustee or receiver in bankruptcy, within the ambit of his office, of any discretion with respect to the safekeeping of bankruptcy funds in a designated depository, reasonably leads to a removal of responsibility for their loss while on deposit.

Petitioners' brief in several places, pp. 15-16, 8, 18, 51, sounds a *caveat* that if the rule stated in the opinion below be followed, bankruptcy funds will be placed in jeopardy. Petitioners, however, ignore the theory of security underlying depository systems. Protection of funds pending payment, administration or distribution is sought not in any individual discretion or control over them by the officer into whose possession the funds come and the corre-

lative imposition of liability in the event of his negligent handling thereof, but in the provision for depositories and for the independent and exclusive exercise of the various administrative functions over them with which the authority that is empowered to select and supervise them is charged. It is true that the system in placing these functions with the bankruptcy court has removed them from the trustee or receiver. It does not follow, however, that bankruptcy deposits are faced with catastrophe. Greater security is ultimately achieved in resting with an independent authority, investigatorial and supervisory powers over places of deposit for all bankruptcy funds in the district. While trustees and receivers are expected to administer their estates with great care and trust, the matter of safekeeping funds in banking institutions has been taken away from their concern, at least to the extent that they are not under a duty of care to ascertain and then judge under risk of civil liability, the condition and stability of the designated depository in which they deposit the funds. There is a high public policy in having controversies over places where bankruptcy funds shall be deposited, decided not by such officers, but by the court.

E.

The Rule of Non-Responsibility is not Affected by the Number of Banks Qualified as Depositories in the District, Assuming Such Question were Before this Court; Nor Does the Rule Present any Issue Under the Fifth Amendment.

Petitioners' brief, pp. 16, 27, 36, contends that where several banks, rather than one, have been qualified as bankruptcy depositories within the district, the rule of non-responsibility is inapplicable, and, instead, there is imposed upon the trustee or receiver in such case a duty to consider, with care, whether the particular depository in

which he makes or maintains deposits is one which an ordinary prudent person would have selected if given as a class for choice, the various depositories qualified. Thus, petitioners assert, in effect, that the trustee or receiver has a duty to evaluate the respective financial condition and position of the various depositories, to inquire into such matters as the relation between the size of the depository bond of each depository and the total amount of bankruptcy deposits in all the various estates which he individually administers. And, presumably, he must ascertain and determine the amount of estate funds deposited and maintained on deposit in each of the depositories from time to time by all of the other receivers and trustees in the district. In their argument, p. 16, petitioners point to twenty-one different banks qualified as depositories when the first deposits were made in 1930 and say that "at all times thereafter * * * there were a substantial number of such depositories". Petitioners criticize, p. 27, the opinion below for an "intimation" that Howard had no power of selection, asserting that "it is an undisputed fact" that at all times "he had numerous qualified depositories to choose between".

Under the depository system in bankruptcy all depositories are in law upon an equal footing. Each is designated by the bankruptcy court and continues under its supervision; each is an officer of the court and subject to summary order. In the nature of the system no duty exists for the trustee or receiver to exercise an individual discretion as to the relative security of the depositories and, in effect, to review the judgment of the designating authority at the risk of being held liable for negligence. Section 61 of the Bankruptcy Act (11 U. S. C. A. 101) in empowering courts of bankruptcy to designate depositories provides among other things that depositories so

qualified shall be located as convenient as may be to the residences of the trustees. This is a clear legislative recognition that trustees and receivers may be guided in making deposits by considerations wholly of convenience and they are not expected to make appraisements in matters of qualification or stability.

Not only is there no requirement in law that a judgment be exercised to select among depositories, the record in this case fails to present the question for review. The only proof offered by petitioners with respect to the other depositories was an enumeration of banks located in Cook County, Illinois, which had had depository bonds on file in the District Court at some time between August 1, 1930 and June 21, 1932, and of the respective amounts, and changes in amounts, of such bonds (R. 112-113).* No proof was ever offered by petitioners that any of these depositories was in a safer condition at that time than the Phillip State. No proof of the relative safety of the depositories was ever made. The record is silent on such questions as whether the other depositories had experienced runs at the time the Phillip State experienced them, what was the state of their financial condition, what was the relationship between the amount of the depository bond of each depository and the total amount of the bankruptcy funds deposited in such depository by all receivers and trustees, what was the reputation of each of these depositories, did they have any affiliation or relationship with other banks which would tend to give them

---

*This evidence was admitted over respondents' objection that the complaint had not averred, in support of its charge of alleged negligence, the existence of other depositories, and that respondents' motion to dismiss the complaint, urging among other reasons the failure so to allege, had been overruled (R. 107-112, 32, 35, 318).

strength in the event they were met by a run. Indeed, other portions of the record indicate that these depositories were far from stable. Two of them failed on June 8, 1931 (R. 138, 113). Two others, both "loop" banks, merged with two others to save the deposits in the former banks (R. 120-121, 112-113). Prior to that time, and during the period under review, another, The Chicago Trust Company had merged (R. 112). Moreover, certain exhibits offered by respondents and excluded by the trial court, showed that each of the two mentioned "loop" depositories had had a depository bond of $50,000, although the respective amounts of their bankruptcy deposits were $1,103,783.32 and $331,333.76 (R. 157, 113).

As heretofore stated, the trial court rejected an offer by respondents to pursue a line of proof showing the respective financial position or strength of the depositories, and, further, prohibited counsel for respondents in their argument to the jury to refer, as of common knowledge, to the general banking situation in Chicago, the district and the country (R. 277, 290-291). From an official report, *Statement Showing Total Resources and Liabilities Of Illinois State Banks—at the close of business June 29, 1935,* compiled by Edward J. Barrett, Auditor of Public Accounts for the State of Illinois and printed under authority of that State, of which report judicial notice may be taken, (*McCrary* v. *Schenebeck,* 191 Ark. 698, 87 S. W. (2d) 572, 574) it appears that nine other of the depositories closed either during the period reviewed or within nine months thereafter, and that two of the depositories, (State Bank of Chicago and the Union Trust Company) had merged with other banks prior to the period under review (R. 112, 113, p. 28 of said report).* Also one of the depositories (Oak Park Trust & Savings Bank of Oak Park, Illinois) was not located

*See footnote, p. 17, *supra.*

in Chicago but in a suburb, and had been designated a depository less than a month before the Phillip State closed (R. 113).

Thus, of the designated depositories existing at some time during that period, five-sevenths either failed or were compelled to merge with others.

In view of the record as above set forth, the issue of selection of designated depositories, were it material in law, is not presented.

Petitioners' brief, pp. 42-44, after describing the opinion below as an "exoneration" of the trustee or receiver "without regard to his negligence or lack of good faith in making and maintaining deposits", contends that such a "release" from "direct negligence or malfeasance" violates rights guaranteed them under the due process clause of the fifth amendment. An examination of the opinion below shows that nothing was stated therein concerning lack of good faith or malfeasance but that the court merely held that where suit was brought on a trustee's or receiver's bond to recover the amount of funds lost in the closing of a designated depository, on the theory that the trustee or receiver had failed in an official duty to examine, ascertain and judge, with care, the financial condition and stability of the bank when depositing, or maintaining deposits of, the funds there, such action was ill-conceived for the reason that the supposed duty was not one imposed by law on the officer and covered by the bond (R. 393-402).

It is self-evident that no constitutional issue is here presented. Indeed, the question which petitioners urge was raised for the first time in their petition for certiorari. Petitioner's statement, p. 42, that the constitutional question "arises because of the opinion of the Circuit Court in the instant case", does not explain their failure to present the question in their petition for rehearing filed in that court.

The proposition that petitioners are being deprived under the decision below of their right to recover for negligence, and hence of their constitutional guarantee, errs among many reasons in its assumption of the supposed official duty. The cases in the note in 38 A. L. R. 1512, to which petitioners refer, are so clearly inapplicable that no discussion is required. The rule quoted from Cooley relates to "vested" rights.

III.

NO QUESTION OF FRAUD, CORRUPTION, MALFEASANCE OR BAD FAITH IS PRESENTED FOR REVIEW.

Petitioners' brief is not limited in its discussion to whether Howard was under an official duty, within the meaning of the bonds sued upon, to determine, with care, the stability of the Phillip State when making and maintaining deposits there, and whether, assuming such duty existed, he had been negligent in that regard. Petitioners assail Howard, pp. 5, 11, 15, 18, 20, 26, 34-39, 50, as being guilty of "corruption", "fraud", "malfeasance" and "bad faith" in his handling of the funds. Their brief pivots about these accusations.

It is unnecessary to inquire at any length into the merits of these charges. Petitioners are seeking a judgment by this Court upon matters of fact and law which are not presented for review. The case was tried in the District Court wholly upon the theory that liability could be imposed under the bonds for "negligence". The complaint and answer which were filed joined issue on whether Howard negligently and carelessly deposited and maintained on deposit in the Phillip State the bankruptcy funds involved, and negligently and carelessly permitted them to remain there (R. 8, 9, 10, 41-42). The evidence which was introduced by both petitioners and respondents related

to the issues as thus joined, and the case was tried and the jury charged on that basis (R. 299). Respondents were not asked to meet nor was the jury asked to decide any charge of corruption, fraud, malfeasance or bad faith.

It is a fundamental principle of judicial review that if a theory of liability tried below differs from that urged on appeal, to such a degree that the decision upon the one would not necessarily conclude the other, the one raised on appeal cannot be considered; that a theory of liability contended for on appeal which rests or may rest on fact issues never submitted to the jury will not be reviewed; that if a party has brought and tried a case on one theory, he will not be permitted on review to change to another which his opponent was never required to meet, *Virginian Ry.* v. *Mullens,* 271 U. S. 220; *cf. Dewey* v. *Des Moines,* 173 U. S. 193.

Petitioners' charges of fraud, corruption, etc., a matter shortly to be discussed, for the most part relate to the loans made by the Phillip State to Howard, pp. 4-7, *supra.* It will be noted that the evidence of these loans was introduced by petitioners, and admitted by the trial court, as proof supporting the theory of "negligence". The complaint alleged that by reason of the loans, Howard had not exercised "reasonable care, prudence and caution" with respect to the deposits in the Phillip State (R. 9, par. 14). The answer denied that because of the loans, or otherwise, Howard had failed to meet the general standard (R. 42, par. 18). The trial court stated in charging the jury that proof of the loans was relevant as showing that Howard, by so borrowing, had "fettered" his judgment and prevented himself from "interpreting things that occurred" of significance in considering the condition of the bank, and from "being impressed" by such occurrences, as a "reasonably prudent man" might have inter-

preted or been impressed (R. 298-299). Respondents objected to the admission of proof of the loans and took exception to the statement of the court, on the ground, among others, that assuming petitioners' theory of the existence of the supposed duty were sound, the evidence did not tend to show *whether* Howard had conformed to the general standard of due care in considering the condition of the depository, but *why* he may not have. See pp. 96-100, *infra*.

Petitioners' argument that Howard had been guilty of fraud, corruption, bad faith, etc., in the performance of his duties apparently reduces itself to this: that Howard entered into a "corrupt" agreement with the officers of the Phillip State to the effect that, p. 17, "in consideration of transferring and depositing his bankruptcy funds in the Phillip Bank, said Bank would make to Howard, personally, unsecured loans sufficient to pay unsecured loans which he then had with the Foreman Bank and the Central Trust Company, and, in addition, would give him further unsecured loans"; that such agreement was one, p. 17, "solely for his personal benefit"; and that because of the loans and agreement, Howard experienced throughout the period, p. 17, "mental limitations" which interfered with his exercising, p. 18, "discretion in selecting between depositories", that is, limited, p. 20, "his power to act", or, p. 36, "his freedom of action".

Petitioners' argument errs in many respects. Its assumption that the bonds sued upon cover a duty to select among designated depositories, begs the question. Its assertion of the making of an agreement to extend loans in consideration of a deposit of bankruptcy funds, is inaccurate characterization. Inasmuch as the facts in this connection have been fully set forth heretofore, pp. 3-7, they will not here be restated.

The basic fallacy of the argument, however, lies in its assumption that the so-called "personal" loans made to Howard by the Foreman Bank, Central Trust and Phillip State were for his individual gain and advantage. Petitioners directly refer to the agreement with the Phillip State as having been, p. 17, "solely for his personal benefit" and imply that the loans from the other two banks were likewise. In the trial court, upon motion or objection of petitioners, respondents were not permitted to show to the jury the purpose for which these loans had been made (R. 207, 208, 223, 229-230, 251-252, 254, 258-259). The basis for the exclusion was immateriality (R. 230). Yet, in this Court, petitioners are resting their argument of corruption, fraud and bad faith upon the supposition that the purpose for which the loans were made involved Howard's personal gain. Howard's loans outstanding at the Foreman Bank and Central Trust, in August, 1930, had been made for the benefit solely of the estates which he administered as trustee or receiver, and the money there borrowed was used to furnish the estates with cash needed for the payment of services rendered by various persons to them (R. 229-230, 258-259, proof offered). Part of the money borrowed from the Phillip State was used in connection with transferring the Foreman and Central loans to the Phillip State, and all of the remainder was used, like these loans, not for Howard's individual use but wholly for the benefit of the estates, money which was kept in a special revolving account and employed in making petty cash advances to the estates in order to meet and pay estate expenses recurring in the course of administration, such as custodian service fees, mimeographing and stenographic fees, insurance, postage, bookkeeping and inventory service fees, etc. (R. 207, 208, 223, 230, 251-252, 254, 258, proof offered). Under the

practice prevailing in the bankruptcy district and approved by the bankruptcy court, trustees and receivers regularly provided the funds for the making of such advances and were allowed reimbursement therefor out of the estates upon approval of their reports by the court (R. 254, proof offered). The loans by the Phillip State to Howard were usual bank loans, bearing the regular rate of interest, made upon the personal financial statement of Howard, and approved by the directors and loan committee of the bank (R. 168, 169, 174, 258). While the loans were personal in the sense that Howard individually bound himself for their repayment, they were not personal in the sense that they were made, as petitioners contend, for his individual gain. The money was borrowed in the interest of efficient and thrifty management of the estates and to avoid continuous petitioning of the bankruptcy court for allowances. One court, in speaking of moneys borrowed by common law trustees for the benefit of their estates, said "it is no answer to say that they could have applied to the court to borrow such funds each time the necessity arose to do so in order to carry on operations", *Purdy* v. *Bank of America*, 2 Cal. (2d) 298, 40 Pac. (2d) 481, 482.

Petitioners' brief, pp. 38-39, strikes out on a different tack. It argues, p. 38, that Howard "used his power over the estates" to obtain "presently a portion of the commission to which he anticipated that he would ultimately be entitled," that these 'anticipated commissions" were "carefully estimated" in connection with determining the amount of loans to Howard. The precise import of this argument is unclear. The record shows that the Phillip State requested Howard to furnish a financial statement before lending the money needed for the estates, that contrary to petitioners' previous contention of an "agree-

ment," the bank extended the loans only upon a showing of Howard's personal wealth. Although the money was borrowed for the estates and would ultimately be repaid in the usual course of administration, Howard was required to pledge his personal credit therefor, a pledge that has proved costly to him (R. 206-207). The financial statement in question showed real estate and some fifteen or sixteen thousand dollars owed Howard on account of advances to, and estimated earnings by way of commission in, various bankrupt estates administered by him.* Loans of this kind had the regular approval of the Chicago Clearing House Association (R. 174). Petitioners evidently find something unconscionable in the financial statement submitted.

IV.

THE RISK COVERED BY THE BONDS DID NOT CONTEMPLATE THE SOLVENCY OF ANY DESIGNATED DEPOSITORY IN WHICH A TRUSTEE OR RECEIVER MAY HAVE DEPOSITED BANKRUPTCY FUNDS.

No surety could reasonably believe in considering the risks assumed by it on a trustee's or receiver's bond that in a real sense it was underwriting the solvency of all designated depositories in the district, at least to the extent of bankruptcy funds there on deposit in excess of the respective depository bonds. If in computing the extent of its risk the surety examined the Bankruptcy Act and General Orders for the purpose of ascertaining the character of duties imposed upon a trustee or receiver in respect to his handling of bankruptcy funds, it would find merely that such officer was under a mandatory obligation to place the funds in a designated depository. On

*Commissions and fees of a receiver or trustee are fixed by statute as to their maximum limits.

further inquiry into the law, it would observe that the risk of loss had been taken over by a depository system in which an authority other than the trustee or receiver selected banking institutions for the deposit of bankruptcy funds, passed upon their qualifications, took depository bonds from them, limited if necessary the amount of deposits which such banks could accept and, in general, exercised a continuing supervisory power over them.

With this the law, the surety in bonding a trustee or receiver in bankruptcy could reasonably rely on the depository system as controlling its risk and assume that it was not undertaking that officers or administrative bodies other than the receiver or trustee were properly judging of the safety and stability of the various designated depositories. Petitioners' brief, p. 20, comments upon the fact that in one of the estates only a $1,000 trustee's bond was required although $132,707 of funds were in the estate. Only on petitioners' theory of risk does this fact seem extraordinary; moreover, the amount of the trustee's bond is fixed by creditors of the particular estate, Section 50(c) of the Bankruptcy Act (11 U. S. C. A. 78(c)).

The Circuit Court of Appeals in its judgment below reversed the judgment in the District Court and ordered a new trial of the case. The Circuit Court of Appeals held that the bonds sued upon did not cover the supposed risk and that consequently the action brought had been ill-conceived. It is respectfully submitted that this judgment was proper and that this Honorable Court should affirm. Should this Court so hold, a consideration of the points hereinafter set forth will be unnecessary.

V.

IF IT BE ASSUMED THAT A TRUSTEE OR RECEIVER IN BANKRUPTCY, IN MAKING OR MAINTAINING DEPOSITS OF BANKRUPTCY FUNDS IN A DESIGNATED DEPOSITORY, OWES A DUTY OF CARE TO GUARD AGAINST LOSS THROUGH A CLOSING OF THE DEPOSITORY, NEVERTHELESS, IN THIS CASE UNDER THE FACTS PROVED AND WHAT MATTERS THIS COURT MAY JUDICIALLY NOTICE, HOWARD VIOLATED NO SUCH DUTY.

In its opinion below, the Circuit Court of Appeals withheld decision on certain rulings of the District Court assigned as error by respondents. The opinion stated that in view of the conclusion which the Circuit Court of Appeals had reached, its decision on these other features was unnecessary (R. 402). These rulings were reserved by respondents for argument in this Court in the *Brief for Respondents in Opposition,* p. 30, filed when the case was here on petition for writ of certiorari, and petitioners in their brief on writ of certiorari have dealt with the questions involved, petitioner's brief, pp. 44-49.

This suit is not the usual one between common litigants. It is of much more serious portent. Without regard to whether the assumed duty be owed, Sam Howard stands at the bar accused of dereliction as an officer of the bankruptcy court and his reputation, standing and character are at stake. From this viewpoint, therefore, there is importance in showing that although it be not conceded that Howard was under the supposed duty, his conduct did not violate it, and the reversal of the judgment in the District Court by the Circuit Court of Appeals should be affirmed.

A.

Condition of the Bank.

The period under review commences with August, 1930 and ends with June 21, 1932. It was a period of great economic upheaval, pyramided failures in industry and banking, and general distress. What Howard in fact did at that time in relation to the safety of the deposits at the Phillip State cannot be compared with the abstraction what an ordinary prudent person would have done under like circumstances, unless notice be taken of the general economic condition and banking situation then prevailing. The verdict in the District Court may better be understood when it is observed that argument of counsel for respondents, in referring to the nature of the times, was interrupted by the court, and that later a direct instruction was given to the jury barring it from considering such matters (R. 289, 290, 291, 295). That the character of the times falls within the fund of common knowledge and experience which may be drawn upon equally by court and jury is well established.

In the case of *Great Northern Railway Co.* v. *Weeks*, 297 U. S. 135, 149, this Court speaking through the Honorable Justice Butler, said:

> "Judicial notice must be taken of the fact that late in 1929 there occurred a great collapse of values of all classes of property—railroads, other utilities, commodities and securities, and that the depression then commenced progressively became greater * * *."

The bankruptcy moneys for which recovery is sought were lost when the Phillip State closed its doors during the run of June, 1932. Prior thereto in the year 1931 three runs occurred at the depository which came to the

attention of Howard. It was proof of these earlier runs and Howard's knowledge thereof which formed the principal basis for submitting to the jury the question of his responsibility, under the assumed duty, and consequently that of his surety, for the loss (R. 298-300).

The occurrence of a run, some time before a bank's closing, may be material in determining liability for deposits made or maintained with knowledge of the run, and lost in a closing. A run places a depositor on inquiry as to certain possibilities affecting deposits which he should investigate. The run might mean that the bank was in an insolvent or unsound financial condition, or was experiencing other internal difficulty. Or it might mean that the bank, although perfectly solvent and sound at the time of the run, had become insolvent or financially unsound because of the very run. Or it might mean not past or existing insolvency or instability but merely in view of circumstances that future runs were possible.

The issue, whether or not Howard failed to exercise the supposed duty of care for the safety of the funds can in nowise be said to concern itself with a disregard of any condition of insolvency or financial instability of the depository. There is not a shred of proof that the depository was in an insolvent or unsound financial condition before or after the occurrence of the runs or at any time prior to its close. The quarter-annual financial statements issued by the depository during the period and filed with the State Auditor, and an audit made by petitioners' auditor in preparing for this lawsuit after the bank closed, are proof of solvency (R. 83-101, 139). The situation was that of a going solvent institution when met by the June, 1932 run. In this respect the case finds no counterpart in any of the numerous decided cases wherein liability was imposed upon persons—not officials who had deposited in

designated depositories—for funds lost in a closed bank. In all of these cases, the duty of care owed was violated by a careless disregard of an existing condition of insolvency or manifest financial instability. Typical are those involving bank officers in public office who kept public funds on deposit in their own banks when they knew them to be insolvent, *Thunder Hawk School District No. 8* v. *Western Surety Co.*, 58 S. Dak. 312, 235 N. W. 921.

The 1931 runs at the Phillip State Bank and Howard's knowledge thereof, if of any significance, show merely that Howard was placed on inquiry as to the possibility of future runs on the depository.

Thus, the issue, whether or not Howard failed to exercise the supposed duty revolves about this fact question: Because of the occurrence of the 1931 runs on the bank and what indication they gave that runs might happen in the future, should Howard, as an ordinary prudent person making deposits in that depository, have judged that the probability of the depository being closed if a future run occurred was so great, although the depository was perfectly solvent and sound, that the propriety of his continuing to make deposits or have deposits there was challenged. As thus stated, the question assumes the possibility of a run, disastrous or otherwise, occurring at the Phillip State and only inquires whether Howard, because of the 1931 runs should have judged that the chance of the depository being closed by a *ruinous* run was such that measures should have been taken with respect to the deposits, if measures were available, to avoid that chance.

Grave doubt must be expressed *in passim* on a matter implicit in this question. The evidence shows that the 1931 runs were all of fortuitous, external origin. Not only were they not caused by, nor for that matter the cause of, any insolvency or instability of the depository; they

resulted from no internal condition of the bank whatsoever. Each of the runs was directly attributable to the general banking situation and unhealthy state of panic in the public mind. The April run came with the closing of several banks, pp. 8-9, *supra*. The June run followed the announcement of the mergers of two of the large "loop" bankruptcy depositories, pp. 9-10, *supra*. The September run occurred when a bank located directly across the street from the Phillip State, failed in the aftermath of the "Bain chain" closing, p. 14, *supra*. It was a time when recurrent waves of runs were taking place, striking all banking institutions, large and small; when national aid in stemming the tide had not yet succeeded and state efforts were hopeless; when "numerous banks and financial institutions all over the country, which had theretofore been not only abundantly solvent but in a flourishing financial condition failed," *Brennan* v. *Eubank*, (Tex. Civ. App.) 56 S. W. (2d) 513, 515. It was a time when great public fear for all banking institutions existed, when hardly an individual then living in urban centers like Chicago and having funds on deposit did not experience very real anxiety concerning his money. It is apparent, therefore, that what caution the 1931 runs bore of the possibility of future runs taking place at the Phillip State, was merely that of the risk then confronted by all solvent and going banks, that is, that runs were striking indiscriminately everywhere without cause and founded on wholly psychological forces.

The question therefore, whether Howard in the performance of the supposed duty should have judged, because of the 1931 runs, that the chances of the depository being closed by a run were such as to warrant the taking of steps with respect to the deposits, assumed not only the possibility of runs occurring, ruinous or otherwise, but

that runs finding their origin in psychiological forces and utterly unpredictable as to direction or extent, could form a basis for a reasonable judgment on what the probabilities were of the bank in fact encountering and being closed by such a run. Whether such prediction could be made is exceedingly dubious. The probabilities of a solvent and going bank being met or closed by a run of psychological cause cannot fall within the scope of logical decision. And the significance is this: If such judgment cannot reasonably be made, no duty of care to make the judgment can arise, and a motion for a directed verdict would be warranted on the mere showing that the duty which is charged to have been violated involved the making of such judgment.

Nevertheless, a retrospective view will be taken and inquiry made as to whether in the light of the occurrence of the 1931 runs on the depository and what indication they gave that such runs might happen, Howard reasonably judged as an ordinary prudent person the probabilities of the depository being closed by a future run. Such a judgment would rest on three factors: *first*: the chance of any run occurring at all; *second*: the formidability of the run if it did occur; *third*: how well the bank could meet it.

If runs stimulated by panic can have some rationality attributed to them, what facts there were upon which to make prediction all pointed away from probability of any run occurring. The facts, all known to Howard, were as follows: The Phillip State was one of the old established institutions in its community. In late 1930, when the period under review commenced, prominent bankers spoke of it as one of the best, if not the best, of the banks on the north side (R. 256) and one year later in the fall of 1931 it was classified as an "A" institution by the

Chicago Clearing House Association in a general survey of the banking situation made at that time (R. 176). The financial statements of the depository published in newspapers according to state law showed at no time during 1931 or thereafter that the bank was insolvent or in an unsound condition (R. 84-101). People knew that the bank had met the three runs in 1931 when banks throughout the city had closed and "loop" banks merged, that in 1932 during the six months prior to the actual close of the bank when runs were being experienced elsewhere (R. 105-107) not a single run occurred at the Phillip State and its business was then in a flourishing condition. In middle 1931, the Phillip State took over the Illinois State Bank of Evanston (R. 129-131). It was also a well-known fact that the Central Trust Company, later the Central Republic Bank and Trust Company, had undertaken to advance and had in fact advanced what additional cash might be or was needed by the Phillip State to meet emergency withdrawals (R. 170-171, 260).

As to the facts upon which the formidability of a future run might have been judged, those just mentioned apply equally here. The reputation of the bank as shown by its history, what bankers thought of it and how it was rated, the solvency of the bank throughout the entire period and its ability to meet the 1931 runs, the relationship with the Central, all would tend to minimize the possibility of a run being large or extensive in the event one occurred, provided, of course, that there may be supposed the existence of any more real basis for reasonably predicting the size or extent of a run originating in psychological sources than for predicting the occurrence of the run itself.

As to judging how well the Phillip State could meet a future run if such occurred, the record shows and Howard knew that the bank was in an unusually strong position.

It had the assured and proved support of another bank, the Central Trust. While at the end of 1931 the deposits of the bank, like those of all banks, had diminished because of runs, the solvency or stability of the bank had in no wise been affected and during the first five months of 1932 deposits were rapidly returning, p. 15, *supra.* In March 1932 the bank reached its highest point of liquidity for the entire period under review, with cash, government bonds and amounts due from other banks constituting 37.54% of the total deposits. This exceptional liquidity was sustained during 1932 (R. 72). Bills payable were reduced during the same five months by about two-thirds (R. 139).

In *Re Stone's Assignment,* 220 Ia. 1341, 264 N. W. 604, the facts were in several respects similar to those present in this case except that no depository system was operative. An assignee for the benefit of creditors, administering the estate of an insolvent debtor, placed estate funds in the Winneshiek Bank which closed in January, 1932. The assignee resigned, and a successor assignee was appointed. The controversy arose on objections raised by the successor to approval of the assignee's report. The successor contended that the assignee, as well as the surety on the assignee's bond, was liable for the loss on the ground of negligence in the safekeeping of the funds. A state statute provided that assignees, common law trustees, executors, etc., could file a petition with any court having jurisdiction over them, asking it to designate some bank as a depository for the safekeeping of the funds entrusted to them, and upon notice and hearing a bank could be designated as a depository for such funds. After designation, no deposits in the bank could be withdrawn without the consent of the court. The evidence showed that before depositing the funds, the assignee had applied for an order

to designate the bank a depository, but failed to give notice. Two issues were presented for decision: *first,* was the assignee absolved from any liability for negligence by virtue of the fact that the bank had been designated a depository *ex parte; second,* assuming the assignee was not relieved, was he liable for allowing the estate moneys originally deposited with the bank to remain there, and depositing additional estate funds, under the facts of the case. On the first issue the Supreme Court of Iowa held that the designation could afford no protection, although it also pointed out that, p. 606:

> "If such order had been procured pursuant to such statutory provision, there would be no further liability upon the part of the appellee as to funds deposited pursuant to such order."

With respect to the second issue, the court held that no negligence had been shown, saying, p. 607:

> "Appellant contends that the appellee was negligent in leaving the deposit in the Decorah Bank, because there were rumors that said bank was not good; because the deposits in said bank were shrinking rapidly; because the banking conditions during the period involved were critical; because many banks were closing; because it was the practice and custom in the northeastern portion of the state, where the assignment was made and where the Winneshiek County State Bank was located, to protect such deposits with collateral security; because there was a vault containing a screw door safe in the Bank of Waucoma where such funds could safely be kept; and because the appellee placed no personal reliance in the Winneshiek County State Bank.
>
> Appellee, on the other hand, presented evidence that the assignee had no personal knowledge of the in-

solvency of the Winneshiek County State Bank; that after his appointment he made inquiry of the cashier of the Bank of Waucoma, of which he was the assignee, in regard to the solvency of the Winneshiek County State Bank and of the advisability of depositing funds therein, and was advised that it was considered a reliable depositary; that he had known of the Winneshiek County State Bank for several years prior to his appointment as assignee, and that it had always borne the reputation of being a strong and reliable bank; that he had for several years and during his incumbency as assignee examined the semiannual published reports of said bank, and that from such reports he had reached and had ground for reaching the conclusion that it was a safe and reliable depositary; that the Bank of Waucoma, of which he was assignee, had used said depositary for years prior to his appointment as assignee; that, in leaving the deposit in the Winneshiek County State Bank, in procuring the order of court naming it as depositary, and in adding to the deposits therein at the time of his appointment, he was acting honestly and according to his best judgment; and that, in so doing, he did not fail to exercise the reasonable care that a person of ordinary prudence would exercise under the circumstances.

We think the evidence in the case is sufficient to show that the Winneshiek County State Bank was regarded as one of the strong banking institutions of the northeastern portion of the State of Iowa; and that, although, during the period of appellee's incumbency as assignee, other banks had been failing throughout the northeastern and other parts of the state, the conditions then existing were not such that the appellee, as an ordinarily prudent person, was

bound to withdraw the funds in his hands from this bank. We cannot agree with the appellant's argument that the safe in the vault in the Bank of Waŭcoma would have been a safer place to keep the deposit than the bank in which he placed it. If these funds had been placed in that safe and had been lost by reason of burglary or robbery, it might, we think, be claimed with better reason than is here presented, that the appellee was negligent in exposing them to this danger. While many banks were failing during the time in question, it cannot be said that people generally realized, or should have realized, that many of the banks which were still operating were insolvent or would be compelled to close their doors. If each person who left a deposit in a bank that later failed can be said to have been negligent in so doing, then it would seem that there were more negligent depositors in many of these banks than there were people who exercised ordinary prudence. A consideration of all of the evidence leads us to the conclusion that the appellee was not guilty of any such negligence as would make him personally liable for the total amount of the funds on deposit by him in the Winneshiek County State Bank."

State v. *Copeland,* 96 Tenn. 296, 34 S. W. 427, 433-434, arose from the 1893 panic. Copeland, a town trustee, and the sureties on his official bond were sued for the loss of town moneys deposited in the Nashville Savings Bank, commonly referred to as Marr's Bank. No depository system was provided by statute and no officer designated Marr's Bank a depository, although the court in its opinion noted that Copeland, prior to making the initial deposit, had conferred with the local judge and secured his oral statement of approval for the deposit. Copeland

also discussed the bank with various bankers and learned it was in good repute in financial circles, that it had withstood previous banking crises and was commonly regarded as solvent. The time, however, was a period of financial panic and various statements that the bank was unsound or would break reached Copeland. The trial court had found as a fact that Copeland was negligent and imposed liability for the loss. The reviewing court, however, took a less stringent view of the duties of care toward trust funds in days of panic and reversed the judgment, ordering the bill dismissed. That court's attitude towards the facts and the extent of care the law imposes under such circumstances appear from the following language:

> "Mr. Estes, the cashier of the Livingston Bank, states, that a short time before the failure of Marr's Bank, he met with Copeland in Nashville. At that time there was a financial panic all over the country, which had affected the country banks as well as the city banks of Nashville. The Capitol City Bank of Nashville closed, and on the next morning witness had a conversation with Copeland, in which the distressed condition of all the banks was commented upon, and in that conversation Copeland stated that he had his money in Nashville, and was a little uneasy about it. * * * Witness intimated to Copeland that Marr's Bank was unsound. * * * A few days thereafter Copeland was in Livingston and * * * on this occasion witness states that he again referred to the unsoundness of Marr's Bank. * * *
>
> The learned chancellor was of opinion that due caution and diligence was not used by defendant. He says: 'In this case the defendant made no personal examination, nor did he have any examination made, as to the solvency of Marr's Bank, nor had the bank

officials made any publication for a long while of its condition, as required by its Charter. He took the opinion of his friends, whom he confided in, but the opinions given were not based upon any examination or actual knowledge as to the solvency of the bank.' Nothing can be predicated to the prejudice of the defendant, that he did not make or cause to be made a personal examination of the bank. * * * The standing of a bank can alone be determined, by outsiders, by its mode of doing business and its reputation in business circles. * * *

The conclusions to which we come * * * are:

1. That the defendant was * * * responsible only for the exercise of good faith, diligence, prudence, and caution, * * *.

2. That it was neither negligence nor want of proper business prudence and caution to deposit the funds in a bank of undoubted standing and reputation. * * *

6. The defendant Copeland was justified in not returning the funds to the Livingston Bank, when the president and cashier of that bank suggested that it be done."

In an astonishingly large number of cases arising from bank failures during periods of financial crisis, some from failures during the 1893 panic, others during succeeding panics including the present depression, common law fiduciaries and other persons under similar obligations of due care towards funds of others, have been absolved from liability for loss of trust or public funds through bank failures, with practically no discussion. The decisions in these cases almost summarily dismiss any question of liability. As illustrative, *Barney* v. *Saunders*, 57 U. S. (16 How.) 535; *Harper* v. *Betts*, 177 Ark. 977, 8 S. W. (2d)

464; *Wilson* v. *People,* 19 Colo. 199, 34 Pac. 944; *Hart* v. *Savary,* 114 Fla. 41, 152 So. 705; *Gross* v. *Butler,* 48 Ga. App. 750, 173 S. E. 866; *Town of Danbury* v. *Riedmiller,* 208 Ia. 879, 226 N. W. 159; *In re Olson's Estate,* 206 Ia. 706, 219 N. W. 401; *Prudential Ins. Co.* v. *Hart,* 205 Ia. 801, 218 N. W. 529; *In re Workman's Estate,* 196 Ia. 1108, 196 N. W. 35; *Carey* v. *Safe Deposit & Trust Co. of Baltimore,* 168 Md. 501, 178 Atl. 242, 248, 250; *In re Mullen's Estate,* 97 Mont. 144, 33 Pac. (2d) 270; *In re Welch's Estate,* 100 Mont. 47, 45 Pac. (2d) 681; *In re Kruger's Estate,* 141 Misc. 475, 252 N. Y. S. 688; *Neff* v. *Harmon,* 145 Okla. 114, 291 Pac. 518; *Clemons* v. *Dennis,* (Va.) 181 S. E. 387; *In re Kohler's Estate,* 15 Wash. 613, 47 Pac. 30.

The existence of the depository system, as well as the part played in it by the designating authority and the designated depository, though it be held not legally conclusive on the matter of Howard's liability under the rule of non-responsibility, certainly must be considered as a fact circumstance in determining whether Howard discharged the supposed duty.

Howard knew that under the statute the bankruptcy court acting in its administrative capacity had exclusive supervision over deposits of bankruptcy funds in the Phillip State, that the court was vested under the law with the sole and absolute power to determine what disposition should or could be made with respect to the funds there on deposit—whether the times required that a restriction of some character should be placed on the making of deposits there, or that the depository bonds be increased, or that the designation itself be revoked and all deposits directed by summary turnover order to be returned to the custody of the bankruptcy court. Knowing this Howard had a right to presume that the designating

authority was familiar with the general condition then prevailing and affecting the safety of deposits in designated depositories of the bankruptcy court, and was performing its administrative functions of supervision and control.

In *County of Marshall* v. *Bakke,* 182 Minn. 10, 234 N. W. 1, 4, in absolving a county treasurer and the surety on his official bond for a failure to withdraw county funds from a depository which had closed, the court said: "all of these officials [the designating authority and authority that approved the depository bond] resided or did their official work in the same place as Bakke [county treasurer] and presumably were as well informed of the financial condition of the banks as he."

In *Rosebud County* v. *Smith,* 92 Mont. 75, 9 Pac. (2d) 1071, 1073, in pointing out that the duty to file a claim against a closed bank for money lost in its closing under law lay with the designating authority and not with the depositing officer, it was said: "the presumption is that * * * the board of county commissioners [designating authority] knew at all times the conditions respecting the county deposits and debts due to and from the county."

In *Board of Education* v. *Nelson,* 33 N. Dak. 462, 157 N. W. 664, 667, where the designating authority did not require, as it had power to do, additional bonds from the depository and the depository failed, the court said of the depositing officer's knowledge of the security, that he "had a right to presume that the school board [designating authority] had performed its duties."

In *Board of Commissioners* v. *Elmund,* 94 Minn. 196, 102 N. W. 719, 720, it was said with respect to depositing officers in depository systems and what they may presume of other officials in the systems: "some benefit must be

given to the presumption that public officials [designating authorities] will and have done their duty."

Also: *State* v. *Krause*, 186 Wis. 59, 202 N. W. 319, 322-323.

Howard could guide himself by much more than a mere presumption in law that the designating authority knew all the circumstances surrounding the deposits at the Phillip State and was exercising what supervisory powers were necessary with respect thereto. The record shows, and Howard knew, that after the first run and apparently at the very time of the second, the authority empowered under law to deal with the question, if any, of safety, with full knowledge of the bankruptcy deposits at the Phillip State, made an investigation of the depository; that that authority thereafter at no time issued any administrative order limiting or restricting deposits, or increasing the bond or directing a withdrawal or any other act or thing to be done; that that authority had issued an order requiring reports giving it special information concerning depositories and deposits there made; and that such reports concerning the Phillip State had been filed with it by Howard himself, pp. 10-13, *supra*. With this knowledge Howard had every right to judge (if he was under duty to judge) that the continued deposit of bankrupt estate funds at Phillip State was perfectly proper.

Nothing has thus far been said concerning the question what Howard should or could have done, if it be assumed that an ordinary prudent person in his position would not have continued making or retaining the deposits at the Phillip State. A word, however, may be said of the point because it serves to emphasize the conclusion that the assumed duty was not violated.

The record does not indicate at what *point of time* during the period under review Howard should have done

something about the deposits at the Phillip State. The dates of the opening of the accounts of the various estates represented in these suits were distributed quite uniformly over the twenty-two months involved (R. 12-29) and this fact suggests in the present inquiry serious questions of proximate cause as to the liability for loss in each of the separate estates. The trial court in its charge to the jury instructed it to find for petitioners if "*throughout* the period that is here under review [the depository] had become a hazardous place to have trust funds [because of the run]" etc., (R. 299). However, there is great difficulty in concluding under any theory that "throughout" the period from August, 1930 to June, 1932 the depository was hazardous. The most than can be said is that at the time of the runs or thereafter the duty to do something on Howard's part arose. What does this duty to do something amount to?

As to funds already on deposit there was only one thing that Howard could do, namely, inform the designating authority that he had deposits in that depository, that the bond of the depository was in the amount that it was, that the times were times of panic and although the Phillip State was perfectly solvent and had met three runs still the times were times of panic, and that the designating authority might do something about the matter. In addition, Howard may have suggested that the designating authority consult with the designated depository about increasing the bond or confer with persons having knowledge. Howard was not an ordinary fiduciary making deposits at a bank, and when he placed the funds in the depository he was prohibited from withdrawing them except by check countersigned by the designating authority or its agent.

It must be clear that as to funds already on deposit when the supposed duty to do something arose, all that could

have been done was in fact done and no liability for not doing it could accrue.

As to deposits of funds yet to be made, when the duty to do something arose, Howard had the privilege under the Bankruptcy Act of depositing them in "one of the designated depositories", 11 U. S C. A. 75 (a) (3). Were there any depositories other than the Phillip State where a deposit would have satisfied the duty? The evidence adduced as to these depositories has already been discussed, pp. 16-17, 63-67, *supra*. From what was there said, it appears that nothing had been shown which would indicate that the other depositories were any safer than the Phillip State, and on the record it must be presumed that they were not.

The trial court in charging the jury instructed that it might consider as a circumstance showing want of due care, the fact that the deposits in the depository exceeded in a substantial amount the penal sum of the depository bond (R. 297). From the standpoint of the amount on deposit in the respective account of each of the estates at the time the bank closed, none exceeded the amount of the bond (R. 61-64, 67). Except for a few larger amounts, the respective deposits in the majority of estates was then around $1,000.

The most that excess might mean in any case is that the duty of care *could* arise. Mere deposits below the amount of the bond, in the absence of a showing that the bond was worthless, and that that fact was known or should have been known to the depositing officer, raises no issue at all.

Assuming, however, that the relative size of the bond was of consequence, what could Howard have done about it? As to deposits already in the depository, all that he might have done would have been to tell the designating

authority of the amount of deposits on hand as compared with the depository bond, and then to ask that the authority give the matter consideration. However, had not that in fact been done? And if so, can liability be imposed on the theory that such act had not been done? As to funds not yet deposited, all that he might have done would have been to make deposits in another depository where the amount of the depository bond did not exceed the sum of the aggregate bankruptcy funds then on deposit in such depository. This would have required an investigation of all the depositories in order to ascertain where such favorable condition existed, although the only person who would know such fact was the designating authority. Nor could he rest there. Upon discovering such depository he could not stop with his first examination but would have to investigate from time to time to make certain that the ratio between the amount of aggregate funds deposited by all receivers and trustees in addition to that which he deposited did not exceed or was not likely to exceed the amount of the depository bond. If such excess developed, he then would be in the same position as he originally was in; he would have to go to the designating authority, tell it about the matter and ask that something be done and, meanwhile, as to future deposits, open new accounts in other depositories until the same situation again presented itself there. The absurdity of these conclusions which one must accept in assuming the existence of a duty to do something, shows that one cannot ignore the existence of the depository system and its method for handling the situation, particularly the equality of all depositories as places of deposit, without regard to size of bond.

Moreover, no showing was ever made by petitioners that the amount of aggregate bankruptcy funds in any other depository, assuming the existence of another depository

as safe as the Phillip State, did not exceed the amount of its depository bond, or the extent to which it did exceed. A witness for petitioners testified to the amounts of the respective bonds of the other depositories (R. 112-113), but nothing was ever introduced as to the relative amount of the aggregate deposits and the depository bonds. Proof offered by respondents, chiefly in other connections, and refused by the trial court showed that in that period at least four of these depositories had aggregate amounts greatly in excess of their depository bond. The First National Bank had about $1,000,000 in bankruptcy funds and a $250,000 bond; the Continental-Illinois Bank had close to $700,000 of deposits and a bond of $250,000; the National Bank of the Republic had over $1,100,000 on deposit and a $50,000 bond; the Foreman Bank had approximately $300,000 in funds and a $50,000 bond (R. 112-113, 157).

A chart setting forth statistical data was introduced below by petitioners showing the relationship, at the end of each month during the period under review, which the amount of aggregate bankruptcy funds deposited by Howard in the Phillip State bore to the total deposits of the bank, to its total individual demand deposits, and to the amount of cash, government bonds and amounts due from other banks (R. 72, 69, 81). Respondents raised several objections to the admission of this evidence, which were overruled (R. 68, 81). The apparent purpose of this showing was to establish that the depository bank was a comparatively small bank and the relative amount of the aggregate deposits in the estate accounts kept with it, was high. The record shows that the ratio of total estate deposits to the total deposits of the bank was in no way exceptional. It varied with each month, sometimes higher and other times lower, ranging from 7.33% to 15.30%.

In most of the months, the ratio was 11% or under. It is common knowledge that in those days, the proportionate amount of bank deposits representing funds belonging to failed businesses administered by trustees or receivers in court proceedings, was much higher than the above ratios.

The admissibility of the chart is exceedingly doubtful. In *State* v. *Copeland*, 96 Tenn. 296, 34 S. W. 427, 434, where the depositor was charged with negligence in not discovering the insolvency of a bank which later failed, the court said:

> "Nothing can be predicated to the prejudice of the • • • [depositor], that he did not make, or cause to be made, a personal examination of the bank. Such an examination, except perhaps by an expert, would have resulted in nothing reliable. Nor would any bank of standing submit to a personal examination by its customers. (Word in brackets added.)

There is no particular significance in the fact that the Phillip State was not a large bank, or that the aggregate amount of the deposits in the accounts kept with it by Howard were around 11%. It is common knowledge that no bank, large or small, then enjoyed special immunity against runs. The bankruptcy court did not consider large banks more proper places for bankruptcy funds than small banks (R. 112-113) and the evidence with respect to the Foreman Bank would not tend to establish such a proposition (R. 120-121). Certainly, whether the supposed duty was performed cannot depend upon the question, which banks were then safer, large or small.

Nor need particular attention be paid to the amount of aggregate bankruptcy deposits kept with the depository during the period. Unless the size of the aggregate amount in itself tended to weaken the depository, and there is

no reason for so concluding, it was without relevancy. Generally, size of deposits in a particular bank during a panic period is important only from the viewpoint of diversification, that is, whether safety might be secured by dividing the aggregate among many banks. But, diversification cannot apply to an aggregate which is the aggregate of the respective amounts of several estates, especially where the respective amounts, as here, were each around $1,000 (R. 61-64, 67). In only six of the entire one hundred and twenty-four accounts in controversy did deposits exceed $10,000, and only two of the six exceeded $20,000 (R. 61-64, 67). From a business and practical viewpoint the smallness of the amount of deposits in each of the separate accounts precluded any possibility of diversification of the funds in each separate account.

B.

Materiality of the proof of loans on whether the supposed duty of care arose and was discharged.

The theory of materiality upon which proof of the loans from the Phillip State to Howard, was admitted, may best be gathered from the charge to the jury (R. 298). The trial court stated: the loans made by the bank were personal obligations of Howard because he was individually responsible for their payment; for what purpose Howard borrowed the money is unimportant because the loans were personal obligations; inasmuch as the obligations were personal, Howard would be reluctant, should the occasion ever have required it, to withdraw the funds on deposit at the depository or to stop making deposits (apparently on the supposition that should Howard have done so the bank would not have granted extensions of existing loans or make new ones to him); this reluctance

to withdraw or cease making deposits was a continuing state of mind in Howard throughout the period reviewed which "fettered" him in that it affected his interpretation of things which then occurred or presented themselves and which bore upon the question whether as an ordinary prudent person in discharging the supposed duty he should continue to make deposits or withdraw them from the depository (R. 298-299).

Assuming that the loans "fettered" Howard and affected his ability to interpret events and facts, what materiality did they have, thus viewed, upon whether Howard performed the assumed duty of care?

In the discussion heretofore an examination was made of the facts and circumstances appearing in the record which Howard would have had to interpret and judge in discharging the supposed duty. Consideration was given to such matters as the 1931 runs, the amount of the depository bond, the size of the depository, etc. It is apparent, though, that whatever pertinency proof of loans may have, the loans themselves do not come within the class of objective circumstances which supposedly would have guided the ordinary prudent person in Howard's position in making or maintaining deposits at the Phillip State. The 1931 runs raised the question (assuming a duty to predict a panic run could arise) whether Howard's conduct was any different from that of an ordinary prudent person under duty to determine whether the probabilities of the depository's being closed were so great as to require something to be done. Similar questions were raised by other facts considered. The supposed "fettering" of Howard's ability to interpret pertinent events and facts as a reasonable person, falls, however, outside the objective data by which the ordinary prudent person would be guided in determining the question of continuing deposits. The

supposed "fettering" was a state of mind personal to Howard. It constituted what the late Justice Holmes termed "the personal equation of the man concerned," *The Germanic*, 196 U. S. 589, 596.

Under the assumed duty, all that could have been required of Howard was that he should have acted with the *same* degree of caution which an ordinary prudent person would have exercised who had not made loans and been "fettered," as Howard is here supposed to have been. This standard was met. What circumstances might have existed, apart from the objective data, which possibly may have motivated him in acting as he did are absolutely immaterial if in fact his actual conduct coincided with the conduct of an ordinary prudent person not affected by the "personal equation."

Was Howard in fact "fettered"? The loans were usual bank loans made by an institution in the business of making loans, without any favor whatsoever attached. They were time loans, generally for three months, bearing interest at rates from 4½% to 6% per annum (R. 77-78). All loans were submitted to the board of directors and loan committee of the bank for approval and were made upon the personal financial statement of Howard. Loans of the type made to Howard had the regular approval of the Chicago Clearing House Association (R. 174). In no wise were they anything but pure business loans.

The purpose for which the money was borrowed by Howard and used by him likewise indicates the absence, in fact, of any "fettering," pp. 3-7, 71-73, *supra*. There was no legal obligation upon Howard to make advances to the estates. The advances were made merely in the convenience of petitioners and as a favor to them to avoid the expense and delay of continuous petitioning of the

bankruptcy court for allowances. It is difficult to understand how money borrowed for this purpose constituted a "fettering" in fact. If at any time Howard, in the exercise of the supposed duty of care, found it necessary to do something, whatever that act might have been, about withdrawing or discontinuing deposits at the depository, or, more realistically, if as a trustee or receiver in bankruptcy together with all other receivers and trustees, he was directed by the bankruptcy court to limit deposits at the depository, or if the court directed the depository by summary turn-over order to return all deposits to the custody of the court, all that might happen in such event would be that Howard upon maturity of the loans would have to pay them unless the bank, as a business proposition, would further extend them, and there is no showing that it would not do so in such case, or if Howard did not want any extension or an extension would not be granted, for him to pay the loans with money from either of two sources, viz., his own funds, or if he had none from an allowance of the bankruptcy court which could be secured upon petition showing the advances already made.

The "fettering" which the trial court assumed, and the jury was instructed to regard, arose in this way: (a) by virtue of the exclusion of all evidence showing the purpose and character of the loans, the loans remained purely personal obligations of Howard incurred in acquiring money to be used, so far as appeared, for whatever frolic he wished, (b) the loans were presumed to have been not ordinary business loans resting upon Howard's financial standing and worth but given him without regard to such matter, (c) the character of the loans being such, that is loans for whatever purpose Howard wished and not based upon his financial worth and reputation, it was assumed that they could not be expected to continue

if Howard withdrew the bankruptcy deposits at the bank or discontinued making deposits there; and *therefore,* Howard was "fettered" if at any time due care would require him to made a withdrawal or discontinue deposits (R. 298). This picture, caused chiefly by the exclusion of the evidence of the purpose for which the loans were made, though immaterial on the issue of due care, cannot be accepted.

VI.

IF THE CASE ON THE RECORD WAS ONE FOR A JURY TO DECIDE, NEVERTHELESS, THE JUDGMENT IN THE DISTRICT COURT WAS PROPERLY REVERSED AND THE CAUSE REMANDED FOR A NEW TRIAL, FOR THE REASON THAT REVERSIBLE ERROR WAS COMMITTED IN THE DISTRICT COURT'S RULINGS UPON THE ADMISSION AND EXCLUSION OF EVIDENCE, IN REMARKS OF THE COURT DURING THE TRIAL, IN RESTRICTIONS PLACED UPON ARGUMENT OF COUNSEL FOR RESPONDENTS, IN INSTRUCTIONS GIVEN TO THE JURY, AND IN REFUSAL TO INSTRUCT AS REQUESTED BY RESPONDENTS.

It has been pointed out that the liability sought to be charged against the respondents did not come within the provisions of the bonds upon which the suits are based; that without regard to such provisions, the responsibility did not exist in law; and, lastly, there was nothing in the record which established a failure by Howard properly to discharge that responsibility, if it did exist, and no issue for a jury in connection therewith was presented by the facts. However, assuming that it be held that the responsibility sought to be imposed comes within the scope of the bonds, that it is of a character recognized by the law and that the facts with respect to the discharge by Howard of

that responsibility are of sufficient weight to warrant a jury's passing upon them, nevertheless, the decision of the Circuit Court of Appeals must be affirmed and the case remanded for new trial, for the reason that the case submitted to the jury was not a proper case for determining that responsibility.

Prejudicial and reversible error was committed with respect to the evidence, the argument of counsel, the remarks of the court and the instructions to the jury. Most of these errors are self-apparent and require little comment. They violated rules which are well known, and accordingly will be dealt with *seriatim* in brief fashion.

A.

The number of assignments of error in the case at bar was necessary in order to preserve the errors committed below.

Petitioners, pp. 44-45, make a point of the number of assignments of error filed by respondents. In each of the cases cited by petitioners, the criticism made was of numerous assignments many of which were not argued or discussed, as for instance in the case of *Local 167, I. B. T.* v. *United States*, 291 U. S. 293, 296, petitioner's brief, p. 46, where some hundred errors were assigned and only five argued. In the case at bar, all of the assignments of error were argued in the Circuit Court of Appeals. This is a case of first impression and the District Court below proceeded throughout on theories which were contrary to what seemed to respondents to be the evident intent of the Bankruptcy Act. It is submitted that an examination of the errors assigned, in view of the record in the case at bar, shows that every one was necessary in order to preserve substantial questions which were ruled upon by the trial court adversely to the respondents, and the decision of which has done respondents grave injustice.

B

Erroneous Admissions of Evidence.

1.

TESTIMONY OF PETITIONERS' WITNESSES WITH RESPECT TO SEEING RUNS, HEARING RUMORS OF INSOLVENCY AND OF MAKING PERSONAL WITHDRAWALS OF MONEY.

The petitioners called to the stand six witnesses in succession who gave eye-witness accounts of runs occurring on the Phillip State, and testified to rumors about insolvency of the bank and to the making of personal withdrawals of their money (R. 117-118, 123-128, 313-314). None of the occurrences testified to happened after June, 1931, which was more than a year before the bank actually closed. The reiteration of the occurrences of runs, none of the stories being very clear, made it appear cumulatively as though innumerable runs had occurred. The statement and restatement of rumors of insolvency had a similar prejudicial effect upon the jury, and particularly was this testimony unwarranted when it appeared that the rumors were neighborhood rumors which were not shown to have come to the attention of Howard. Perhaps most unjustified of all and thoroughly incompetent was the testimony of the making of personal withdrawals by the witnesses of all of their deposits in the bank. The psychological effect upon the jury was the impression that anyone would have withdrawn his or her money from the bank, as indeed the witnesses did. The six witnesses presented themselves as an array of persons of ordinary demeanor and status, all of whom had been successful in not having permitted their funds to remain in the bank. The test for determining whether or not Howard exercised due care does not concern itself with some selected set of individuals who in fact with-

drew their money, individuals not remotely occupying the position which Howard did with respect to the funds on deposit.

2.

LOANS MADE BY PHILLIP STATE BANK TO HOWARD.

On several occasions during the course of the trial and in charging the jury, the making of the loans by the Phillip State to Howard was the subject of severe criticism by the trial court (R. 167, 215, 325, 298, 338). Thus, in commenting during the trial upon the making of loans to a receiver by a bank, for the purpose of administering a receivership estate, the loans being based on receiver's fees which have accrued in the estate, the court said:

> "Well, it is just an intolerable sort of thing. Nobody could give any sanction to that sort of thing • • • The idea of a bank—" (R. 167, 324-325).

In charging the jury, the court spent almost one-half of its time in again commenting severely upon the loans, saying among other things, that they were:

> "• • • utterly repugnant to what the situation permitted; not only under the law but upon any sort of a test of propriety permitted either to the bank or to the trustee" (R. 298, 338).

To a jury not thoroughly versed in the external standard of the ordinary prudent man, the mere introduction of the evidence which indicated only the personal equation and had no bearing on whether in fact the conduct of Howard conformed to the required standard, was obviously prejudicial, especially so when this evidence was repeatedly brought to the attention of the jury in a man-

ner most unfair to Howard. A restriction of the proof to the bare fact of the loans, a refusal to show the purpose for which the loans were made, a failure to distinguish between a personal loan amounting to a personal gain for the trustee or receiver and a loan for which he is personally liable but assumed for the benefit of his estate, all have been amply covered, pp. 3-7, 71-73, 96-100, *supra*.

3.

STATISTICAL DATA SHOWING COMPARISON PER MONTH BETWEEN ESTATE DEPOSITS AT THE PHILLIPS STATE AND VARIOUS ASSETS AND LIABILITIES OF BANK.

Petitioners introduced in evidence a chart setting forth statistical data showing the relationship, at the end of each month during the period reviewed, which the amount of aggregate bankrupt estate funds deposited by Howard in the Phillip Bank bore to the total deposits of the bank, the total individual demand deposits, and to the amount of cash, government bonds and amounts due from other banks (R. 72, 69, 81, 316-318). No showing was made that Howard knew of this month by month data. At pages 94-95, *supra*, the incompetency of this proof on the question of Howard's having exercised the supposed duty of care, was discussed. Moreover, the data itself merely singled out certain assets and liabilities of the bank as a basis for comparing the amount of estate deposits kept there by Howard and ignored other assets and liabilities. When this objection was raised by respondents, petitioners introduced a complete monthly statistical chart showing all assets and liabilities throughout the twenty-two months reviewed (R. 139). It too, was incompetent, as not being proper source material by which to judge the conduct of a person in Howard's position.

4.

EXISTENCE OF OTHER BANKRUPTCY DEPOSITORIES DURING THE PERIOD REVIEWED.

A witness for the petitioners testified to the twenty-one banks which had on file depository bonds at some time during the period (R. 112, 318). The impression given to the jury was that there were other places where Howard could have deposited the estate funds which were safer than the Phillip State. However, on the particular question as to the financial condition of these other depositories and such matters as the relationship between the amount of the bankruptcy funds deposited with them and the size of their respective depository bonds, nothing was shown. The objection of respondents to the admission of this line of proof has already been pointed out, pp. 16-18, 65-67, 93-94, *supra*. Upon the failure of the petitioners to establish the condition of the other depositories and the relationship between the bankrupt estate funds deposited with them and their respective bonds, the court should have excluded this evidence as prejudicial.

C.

Erroneous Exclusions of Evidence.

1.

PURPOSE FOR WHICH HOWARD BORROWED MONEY FROM PHILLIP STATE BANK AND PRACTICE OF TRUSTEES AND RECEIVERS IN BANKRUPTCY WITH REGARD TO MAKING ADVANCES TO ESTATES OUT OF THEIR PERSONAL FUNDS.

After the trial court overruled the objections of respondents to the admission of proof of the loans made

by the Phillip State to Howard, respondents offered to show that part of the money borrowed, had been used in paying debts which had been incurred by Howard in securing cash which he needed to pay out to different individuals for services rendered to the various bankrupt estates administered by him, as receiver or trustee in bankruptcy (R. 230, 229, 258-259, 326); and that the remaining money borrowed by Howard from the Phillip State had been secured for the sole purpose of, and was in fact used in, making personal cash advances to the various bankruptcy estates administered by him as receiver or trustee in bankruptcy in order to pay estate administration expenses such as custodian service fees, mimeographing and stenographic fees, insurance, bookkeeping and inventory service fees and so forth; that in the years 1930, 1931 and 1932 Howard made cash advances of this character to all of the estates in bankruptcy administered by him as receiver or trustee and that the amount thereof was very substantial; that at the time of the close of the bank the amount advanced to the estates involved in these suits alone was over $12,000; that the advances thus made to the particular estates with the money thus borrowed had been uniformly repaid to Howard at the time his report as receiver or trustee of any given estate was approved by the referee in bankruptcy and the bankruptcy court, and that while such advances were always so approved, some eight to ten months would elapse between the making of the advances and repayment (R. 206-207, 208-215, 251-252, 254, 324, 325-326). The respondents also offered to show, that for a period of at least ten years there existed among receivers and trustees in bankruptcy appointed by the District Court for the Northern District of Illinois, a general, well known and uniform practice to advance moneys

out of their individual funds on deposit in the bank to estates being administered by them in order to defray estate expenses, that such advances were regularly repaid upon approval by the court of the receiver's or trustee's report and that this practice was known to and approved by the referees and judges of the District Court (R. 254, 207-208, 326).

The foregoing evidence showing the purpose for which the money was borrowed from the Phillip State and establishing that the money was not used for Howard's gain, became vitally important when the trial court permitted the petitioners to show the fact of the loans. Without the above proof, the loans appeared as having been made wholly for the personal advantage of Howard and dependent for their continuance upon Howard's making deposits of bankruptcy funds in the depository. For all that the jury might know, the offered proof having been excluded, Howard had been risking bankruptcy funds in order to secure substantial amounts of money to be used as his personal pleasure directed. If proof of the loans was at all material, by that very reason the explanation of them became material. Otherwise, the jury was left in the position of being able to believe that Howard had been disloyal as a trustee or receiver in bankruptcy, or even guilty of unlawful conduct, and such belief would be bound to color its decision on the issue here assumed as properly presented to it, viz.: whether due care had been exercised by Howard.

Indeed, to say that the jury might so have concluded is putting it too mildly. As has already been pointed out, the trial court in its charge, with the offered evidence of defendants refused, proceeded to tell the jury that such loans were improper, not only in law but "upon any sort of a test of propriety" (R. 298). And, in another part of the

charge the trial court submitted for its consideration the question: "How should these proofs (referring to the evidence in the case such as the 1931 runs) have impressed a reasonably prudent man having no desire other than to safeguard and to conserve, with a singleness of devotion to the trust obligation, how should they have impressed Mr. Howard during this period of time, with respect to the course that he should pursue?" (R. 299). Aside from the incompetency of the question, because of its erroneous assumption that matters of personal equation are material in a negligence case (see pages 97-98, *supra*), the question, following as it did after the court's denunciation of the loans as occasioning a "fettering" of Howard, permitted the jury to give but one answer—that Howard had been lacking in "singleness of devotion." However, had the jury been given the opportunity to know that the money had been borrowed for estate purposes, had it been told that Howard, without any real necessity, had pledged his personal credit for both the convenience of creditors of the estates and in order to save the bankruptcy court the necessity for passing upon the propriety of numerous minute disbursements none of which could be questioned, the jury might very well have answered the question of "singleness of devotion" in another way.

2.

AMOUNT OF BANKRUPTCY FUNDS DEPOSITED BY RECEIVERS AND TRUSTEES IN DEPOSITORIES OTHER THAN THE PHILLIP STATE DURING THE PERIOD UNDER REVIEW.

When petitioners were permitted to show, over the objection of respondents, the existence within the district of bankruptcy depositories other than the Phillip State (R. 112-113), respondents offered to show that with re-

spect to two of these other depositories, namely, the Continental-Illinois Bank & Trust Company and the First National Bank of Chicago, the amount of bankruptcy funds on deposit with them in fall of 1931 was greatly in excess of their respective bonds (R. 283, 319). The respondents also offered to show, in another connection but here likewise pertinent, that the amount of bankruptcy funds in two of the other depositories, namely, the Foreman Bank and the National Bank of the Republic was also greatly in excess of their depository bonds (R. 157, 322). The offered proof tended to establish that so far as Howard was charged with negligence in making deposits in excess of the depository bond, such practice was true generally in the other depositories and the designating authority did not view mere deposits in excess as of any importance. This evidence was also relevant in several other situations heretofore discussed. See pp. 60, 89-90, *supra*. Upon admitting proof of the existence of other depositories and the amounts of their respective bonds, the trial court should have permitted the respondents to show the facts as to these other depositories and that there was nothing unusual in the amount of bankruptcy funds on deposit greatly exceeding the amount of a depository bond. Failure to permit such showing was prejudicial in that the jury might have believed that there was something unusual.

3.

THE REASON FOR THE CLOSING OF THE PHILLIP STATE.

The trial court refused to permit the respondents to show that on June 20th, the day preceding the closing of the Phillip State Bank, Beutel, its president, had a conversation with Philip R. Clark, president of the Central Republic Bank at which time Clark told Beutel that the

Central Republic would advance to the Phillip State all funds needed to meet the June run on the Phillip (R. 178, 315). The court further refused proof showing that the cause of the closing of the Phillip State was the repudiation by the Central Republic of its promise to advance funds to the Phillip State; the court also would not permit a showing of the circumstances under which the Central Republic made its refusal (R. 178, 315).

Heretofore, in discussing whether Howard, in view of the 1931 runs, acted reasonably in judging the probabilities of the bank's being closed by a panic run (assuming any person, even if under a duty of care, could make such a judgment, see pp. 78-81, *supra*) the relationship between the Phillip State and the Central Republic was pointed to as a circumstance tending to minimize the risk of closing. The promise of the Central to assist the Phillip State with what ready cash was needed to meet an emergency run and the actual giving of this assistance during the 1931 runs, had an important bearing upon whether an ordinary prudent person in Howard's position would have judged as Howard did. Upon proof that the Phillip State was closed in June, 1932, by a run, the question which would arise in the mind of the jury was whether the assistance of the Central had been given at that time as it had on prior occasions. If the assistance had been given and the Phillip State nevertheless closed, the jury very likely would presume that the Phillip State had closed from some cause other than the panic. If such an inference could be drawn, then the cause of the closing which Howard, in the exercise of the assumed duty of care would have had to judge on the facts as he knew them and predict, would change from cause to cause as the jurors conjectured on what the cause of the closing really was. No longer would the question

for them to decide be whether Howard reasonably judged these facts and predicted the probabilities of the bank's being closed by a panic run, but whether he reasonably judged and predicted whatever the jury, in the absence of the offered evidence, concluded *might* have been the cause of the closing. The jury was entitled to know that on the occasion of the June run, the assistance had been withheld from the Phillip State, and the closing was nothing more than the inability with which any bank during that period, would have been faced, when met by a panic run, namely, to convert its assets into funds necessary to meet the withdrawals of depositors.

4.

INQUIRY MADE IN EARLY JUNE, 1931, BY THE DESIGNATING AUTHORITY INTO THE GENERAL BANKING SITUATION THEN PREVAILING AND THE AMOUNTS OF THE BONDS OF THE DEPOSITORIES IN BANKRUPTCY; THE TELEPHONE REQUEST MADE OF ALL TRUSTEES AND RECEIVERS TO FILE WITH THE AUTHORITY A REPORT OF BANKRUPTCY FUNDS IN THE DEPOSITORIES AND HOWARD'S REPORT OF JUNE 9, 1931, WITH REPECT THERETO; THE EXERCISE OF ADMINISTRATIVE FUNCTIONS BY THE COURT THEREAFTER.

The trial court refused to admit evidence offered by the respondents of the following occurrences: On or about June 8, 1931, Judge Carpenter, then senior judge of the district court, held a conference with the clerk of the court for the purpose of discussing the banking situation, particularly the deposits of bankruptcy funds in the depositories (R. 144, 145, 319). The whole subject was reviewed with the judge, the amounts of bankruptcy funds in the depository were gone over, the size of the depository bonds examined (R. 145, 319). Judge Car-

penter directed Muir to telephone the various receivers and trustees in bankruptcy of the district court and request them to file statements showing in what depositories they kept their bankruptcy estate funds and the respective amounts thereof (R. 148, 320, 321). Following this conference, Muir promptly telephoned the receivers and trustees, including Howard, and told them of the court's request for a statement (R. 148, 263, 320, 321). On June 9, 1931, in compliance with Muir's request, Howard filed a report showing the amount of bankruptcy funds belonging to estates administered by him, on deposit in the Phillip State Bank and the Foreman Bank (R. 148, 263, 154-155, 320, 321).

The above evidence was highly important as part of the case and no plausible reason for the refusal to admit it is evident. Even if the existence of the depository system did not remove from Howard all responsibility to determine, with care, the condition and stability of the bank in making and maintaining deposits, nevertheless, the depository system, his part in it, and the authority exercised by the designating authority, constituted circumstances which entered into the judgments which he would have to make, and which must be considered in determining whether in making such judgments he acted as a reasonable prudent person. This has already been observed, pp. 88-90, 92-93, *supra*. The foregoing occurrences show that in the midst of the June, 1931, run period, following the mergers of the "loop" banks, the designating authority was acting to determine what could be done, if anything, about bankruptcy depositories and the security of bankruptcy funds. The telephone request made of Howard for a report not only shows the informal way in which the court as an administrative officer acted but that there was called to Howard's attention at the very

time of the second 1931 run, the fact that the designating authority was exercising its supervisory powers and investigating the situation. Howard would have the right, thereafter, to guide himself by that knowledge and to assume that if the Phillip State was not a safe depository, the designating authority, with exclusive power to decide the question, would so indicate by some order. The bankruptcy court issued no such order and Howard, knowing that fact, could control his conduct by it. The evidence was also important as showing that in the midst of that high panic period, the court requested and had given to it a report showing the amount of estate funds in the Phillip State, pp. 10-13, *supra.*

The trial court also refused to permit respondents to show further facts surrounding the functioning of the bankruptcy court later in summer after the receivers and trustees had filed their July, 1931, reports under the June 11th order. The evidence refused showed that Judge Carpenter instructed the clerk to bring him all periodic reports filed under the June 11th order (R. 162, 323), and that the judge, upon receiving the June reports, had his secretary prepare for his use a typewritten compilation based thereon, giving, in the instance of each bank depository, the names of all receivers or trustees who kept deposits there and the amounts, both separately and in the aggregate, of their deposits (R. 156-158, 322). The compilation stated the amount of Howard's deposits in the Phillip State and Foreman Bank and disclosed, among other things, in the National Bank of the Republic, the bank which had been merged in early June with the Central Trust and whose depository bond had been fixed at $50,000, an aggregate of $1,103,783.32 of bankruptcy deposits; in the Foreman Bank, the other "loop" bank which had then merged

and whose depository bond was also $50,000, an aggregate of $331,333.76 of deposits (R. 157, 113). While the foregoing evidence was not known to Howard, it nevertheless was important as part of the case necessary to show the jury precisely how the depository system functioned in those days in order that it might judge, in the light thereof, Howard's performance of the supposed duty of care.

Howard was not a common law fiduciary but an officer in bankruptcy with certain powers and certain relationships, and if the jury was entitled at all to determine his performance of the supposed duty of care, Howard in turn was entitled to have the jury consider all the circumstances of his office and position. For the trial court to have had the jury judge Howard's conduct by separating him from his office, and relationships with others in the depository system, meant simply to try him not under the circumstances as they existed but apart from them. His office and these relationships were circumstances of the case which the jury should have had explained to it and shown by the evidence.

Petitioners' brief, p. 46, contends that the only "proof of judicial action is the record of the court," and "what a particular judge" may have done is not competent. This contention indicates a want of understanding of how administrative functions are performed by judicial bodies. The bankruptcy court, in appointing a depository and continuing its designation, is no more expected to conduct hearings in open court as to the condition of a bank than it is expected to hear witnesses and conduct a judicial hearing to determine the fitness of a person to be appointed a referee, or his lack of fitness for removal purposes. See *Board of Finance* v. *First National Bank,* 71 Ind. App. 290, 124 N. E. 768, 770, discussed pp. 46, 58, *supra.*

D.

Improper Remarks of the Court During Trial.

Reference has already been made to certain remarks of the trial court with respect to the loans made by the Phillip State to Howard, viz.: "Well, it is just an intolerable sort of thing * * * the idea of a bank—" (R. 167). These remarks were highly prejudicial and related to a subject wholly immaterial, see pp. 96-100, *supra*. Error was assigned on these (R. 324-325).

E.

Improper Restrictions Placed by the Trial Court upon the Argument of Counsel for Respondents to the Jury.

Counsel for the respondents, in arguing to the jury at the close of all proof, referred to the general banking situation prevailing in the City of Chicago, in the district and in the country prior to and at the time of the closing of the Phillip State Bank (R. 288-291). The district court stopped counsel and refused to allow such argument to be made to the jury. Error was assigned (R. 327-329). The purpose of this argument was to place the occurrence of the 1931 runs in its historic setting in order that the jury in viewing it might properly decide how such circumstance would have affected the judgment of Howard as an ordinary and reasonable person in performing the supposed duty of due care. The jury could not judge fairly Howard and his supposed responsibility towards the funds during the years 1931 and 1932 without being able to draw upon its common knowledge as to the general state of panic which then existed. That the jury was privileged to consider such matters as of common knowledge, *Great North-*

ern Ry. Co. v. *Weeks,* 297 U. S. 135, 149, quoted heretofore at p. 76, *supra; Brennan* v. *Eubank* (Tex. Civ. App.) 56 S. W. (2d) 513, 515; *Home Building & Loan Association* v. *Blaisdell,* 290 U. S. 398, 422, 444; *Carey* v. *Safe Deposit & Trust Co. of Baltimore,* 168 Md. 501, 178 Atl. 242, 248, 250. While the foregoing cases dealt with what a court might judicially notice of economic conditions occurring in 1929 and thereafter, it is well established that the jury may consider as of common knowledge, matters of which the court may take judicial notice, Wigmore, *Evidence,* (2d Ed.) Vol. 3, Sec. 1801.

F.

Improper instructions to the jury.

1.

REVERSIBLE ERROR WAS COMMITTED BY THE DISTRICT COURT IN INSTRUCTING THE JURY THAT IT COULD NOT CONSIDER OCCURRENCES OUTSIDE THE PROOF IN THE CASE ALTHOUGH SUCH OCCURRENCES WERE MATTERS OF COMMON KNOWLEDGE.

The trial court instructed the jury:

> "There were references in the testimony to what were characterized as matters of common knowledge, asserted occurrences outside of any proof here, assumed at the time, or since then, to have come to your knowledge as men of affairs in this community; and it was suggested, necessarily by implication, that you take those matters into consideration in determining this case. That, you are not privileged to do gentlemen," (R. 296, 333).

This portion of the charge referred to the argument which counsel for respondents sought to make, based on occurrences of the depression and panic period during the

years 1930 to 1932 (R. 287-291, 327-328). The instruction barred the jury from all consideration of the character of the times in deciding whether Howard acted as a reasonably prudent man in continuing to make deposits of bankruptcy funds at the Phillip State. To the jury, runs were occurring at the Phillip State and whatever few other banks chanced to be touched upon in the evidence but nowhere else. Howard was made to appear as a person who continued making deposits of estate funds in a bank that had runs when elsewhere placid banking conditions prevailed. The state of the public mind in those days, the waves of runs sweeping over all banks, large and small, the psychological forces which drove people to the windows of paying tellers, all were kept from a jury charged with deciding whether an individual's judgment with respect to runs on a bank when those events were happening, was reasonable. What has been said above with regard to the unwarranted limitation placed by the court on the argument of counsel for the respondents is here applicable.

2.

REVERSIBLE ERROR WAS COMMITTED IN THE COMMENTS OF THE COURT ON THE MATTER OF THE LOANS MADE BY THE PHILLIP STATE TO HOWARD.

The nature of the comment indulged in by the trial court in dealing with the loans which were made to Howard by the Phillip State, the characterization of the loans as "repugnant not only under the law but upon every test of propriety", as "fettering" Howard in the discharge of his duties, and as interfering with the single devotion required of him in the care of trust funds, have been discussed heretofore and were tantamount to telling the jury to hold Howard and his surety liable on a basis of disloyalty, if nothing else (R. 298-299, 338-340). See pages 103-104, *supra*.

3.

REVERSIBLE ERROR WAS COMMITTED IN INSTRUCTING THE JURY TO DISREGARD THE RELATIONSHIP BETWEEN THE CENTRAL TRUST AND THE PHILLIP STATE IN DETERMINING WHETHER AN ORDINARY PRUDENT PERSON WOULD HAVE MADE DEPOSITS IN THE PHILLIP STATE DURING THE PERIOD UNDER REVIEW.

The trial court instructed the jury:

> "• • • and you have a right to go through the whole body of the evidence and determine what facts he [Howard] knew respecting the condition of that bank: • • • and in that connection I want to say to you that those facts must be the facts that deal with the condition of the bank; and if, as is true, it was stated by men connected with other banks that they might or would stand back of it, that those things were communicated to Howard with the idea of indicating a hopefulness on the part of those who communicated those facts to him; those facts, none the less, did not change the condition of the bank, nor alter the duty which the law imposed upon the defendant Howard in respect of these funds" (R. 299-300, 342).

The foregoing instruction was highly improper, both in prejudical effect and in stating the law. The jury were thereby told to ignore the relationship between the Phillip State and the Central Trust. This relationship constituted one of the pieces of evidence the jury had before it in deciding whether Howard had judged as a reasonable person would have; yet the court directed the jury to ignore it.

4.

REVERSIBLE ERROR WAS COMMITTED IN PRESENTING THE CASE TO THE JURY IN A ONE-SIDED WAY.

With the exception of one sentence, the entire charge presented only the side of petitioners, and then did that in a way not warranted in law or by the evidence. Error was assigned (R. 343-344).

5.

REVERSIBLE ERROR WAS COMMITTED IN DIRECTING THE JURY UPON WHAT CONDITIONS THEY WERE TO FIND FOR THE DEFENDANT.

The trial court instructed the jury:

> "Now, if, upon a careful survey of all of this evidence, you feel that this bank was in a safe condition, and that there was nothing there involving hazards, great hazards to the trust funds, and that the defendant Howard knew of nothing that would challenge his right to continue not only to deposit, but to increase the deposits in the light of all the evidence here, as developed, your verdict in this case should be for the defendants" (R. 299, 341).

The foregoing was the only instruction stating to the jury on what conditions they were to find for the respondents. That charge was patently in error, and would itself afford ground for a reversal. The jury should have been instructed that if it found that Howard acted as an ordinary prudent person under the circumstances of the case, etc., viz., the general standard of care required of all defendants in negligence cases, then it was to find for the respondents; not that the jury was to find

for the respondents only if the three stated facts co-existed. The instruction amounted to a directed verdict for petitioners, because it instructed that unless the jury found the three facts stated in the instruction, it was to find for petitioners, and inasmuch as the issue of due care was not included among the three facts stated, in effect the jury was directed to find for petitioners on the issue of due care, the issue of the case. If Howard is to be tried for failing to exercise due care under the circumstances of the case, he was entitled to have the jury instructed accordingly.

F.

Reversible error was committed in refusals of requests of respondents to instruct the jury.

From what has been said heretofore the error of the trial court in refusing to give the following instructions requested by respondents is evident. The court refused to read to the jury the provisions of the Bankruptcy Act pertaining to the duties of trustees and receivers and the designation and supervision of depositories (R. 330-332), to instruct that if the judge of the bankruptcy court knew the amount of bankruptcy funds on deposit in the Phillip State, the size of the bond and failed to increase the amount of the bond, Howard had the right to assume the court believed the bank a safe place to maintain such deposits (R. 332-333), and refused further to instruct that no duty was owed as a matter of law to limit the amount of deposits of bankruptcy funds in the Phillip State to the amount of the depository bond of said bank (R. 329).

CONCLUSION.

For all of the foregoing reasons, it is respectfully submitted that the judgment of the District Court below was erroneous, and that accordingly, the judgment of the Circuit Court of Appeals for the Seventh Circuit, in reversing said judgment of said District Court and remanding the cause for a new trial, should be affirmed.

Respectfully submitted,

JULIUS MOSES,
LLOYD HETH,
WILLIAM P. SMITH,
Counsel for Respondents.

WALTER BACHRACH,
STANLEY J. MORRIS,
R. WEYAND,
Of Counsel.